Regulatory Reform Alert

We're Almost There! Financial Reform Almost Final as Attention Turns to Rulemaking

In the early morning hours of June 25, a House-Senate Conference Committee ("Conference Committee") agreed on the most sweeping financial regulatory reform legislation in over 75 years. On June 30, by a 237-192 vote, the House approved a modified version of the legislation,[1] dubbed the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (the "Act") in recognition of the roles played by Senator Chris Dodd and Representative Barney Frank. The Act is currently awaiting a vote in the Senate, which is expected sometime during the week of July 12. While passage is by no means certain, most analysts currently predict that the Senate will vote to approve the bill, which will then be sent to the President for his signature. The Act will be effective one day after enactment, unless otherwise provided.[2]

The Act creates a number of new regulatory, supervisory, and advisory bodies and it touches on the regulation of virtually every aspect of US financial markets and activities. Nevertheless, it also leaves an extraordinary number of matters to be addressed through rulemaking and other regulatory action, giving the regulators significant discretion in many areas. Thus, even if enacted, it will take some time for the final shape and effect of the legislation to emerge. The bill also mandates the preparation of studies of a wide range of issues, which could lead to more regulatory change.

The over 2,300-page Act is enormously complex and our analysis will be ongoing. This memorandum summarizes the principal provisions of the Act, as voted on by the House, and is organized by title. We plan to update our analysis through follow-up memoranda focused in more detail on specific areas as we continue to review the Act's provisions.[3]

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[1] The Conference Committee reconvened on the evening of June 29 to restructure provisions that would have assessed large banks and hedge fund managers in amounts sufficient to raise up to the $19 billion costs for implementation of the legislation.
[2] The Conference Committee Report, referred to in this memorandum as the "Act," is available at http://www.wilmerhale.com/files/upload/Conference Report.pdf.
[3] This memorandum was prepared with the assistance of summer associates Jennifer Bunn, April Elliott, Lesley Fredin, Misan Ikomi, and Alex Jadin.

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I. ABBREVIATIONS

Abbreviation	Description
ABS	asset-backed securities
Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
Advisers Act	Investment Advisers Act of 1940
Bureau	Bureau of Consumer Financial Protection
CFTC	Commodity Futures Trading Commission
Conference Committee	House-Senate Conference Committee
Council	Financial Stability Oversight Council
DCO	derivatives clearing organization
EESA	Emergency Economic Stabilization Act of 2008
EFTA	Electronic Funds Transfer Act
exchange	designated contract market, exchange, or swap execution facility
Exchange Act	Securities Exchange Act of 1934
FDIC	Federal Deposit Insurance Corporation
federal banking regulators	OCC, Federal Reserve, and FDIC
Federal Reserve	Board of Governors of the Federal Reserve
FFIEC	Federal Financial Institutions Examination Council
FHFA	Federal Housing Finance Agency
FIO	Federal Insurance Office
FTC	Federal Trade Commission
GAO	Government Accountability Office
GASB	Government Accounting Standards Board
HOEPA	Home Ownership and Equity Protection Act

Abbreviation	Description
HOLA	Home Owners' Loan Act
HUD	Department of Housing and Urban Development
IMF	International Monetary Fund
Investment Company Act	Investment Company Act of 1940
Mortgage Reform Act	Mortgage Reform and Anti-Predatory Lending Act of 2009
MSRB	Municipal Securities Rulemaking Board
NCUA	National Credit Union Administration
NRSRO	Nationally Recognized Statistical Rating Organization
OCC	Office of the Comptroller of the Currency
OFR	Office of Financial Research
OHC	Office of Housing Counseling
OTC	over-the-counter
OTS	Office of Thrift Supervision
PCAOB	Public Company Accounting Oversight Board
SEC	Securities and Exchange Commission
Securities Act	Securities Act of 1933
SIPC	Securities Investor Protection Corporation
SRO	self-regulatory organization
TARP	Troubled Asset Relief Program
TILA	Truth in Lending Act
Transfer Date	date designated for transfer of functions to the Bureau
Treasury Department	Department of the Treasury

II. EXECUTIVE SUMMARY

A. Title I: Financial Stability

Title I establishes a broad regulatory framework to protect the US financial system from the systemic risks posed by certain financial companies and activities. It creates a new entity, called the Financial Stability Oversight Council ("Council"), to identify risks to US financial stability, promote market discipline, and respond to threats to the stability of the US financial system. The Council may vote to determine that nonbank financial companies should be supervised by the Board of Governors of the Federal Reserve ("Federal Reserve"). Title I also authorizes the Federal Reserve to subject the activities of nonbank financial companies under its supervision and large, interconnected bank holding companies to more stringent prudential standards and reporting and disclosure requirements. The Council may also recommend additional standards and safeguards to the primary financial regulatory agencies for financial activities or practices conducted by bank holding companies or nonbank financial companies more generally.

B. Title II: Orderly Liquidation Authority

Title II creates a new liquidation authority, which allows the Federal Deposit Insurance Corporation ("FDIC") to unwind failing bank holding companies and nonbank financial companies when necessary to prevent serious adverse effects on national financial stability. This new orderly liquidation authority is subject to strict conditions—including a recommendation from at least two federal regulators as well as the action of the Secretary of the Treasury in consultation with the President, and subject to judicial review. Taxpayers are expressly protected from losses and taxpayer bailouts of failing firms are expressly prohibited. There will be no prefunded resolution fund. The FDIC may fund a liquidation by borrowing from the Department of the Treasury ("Treasury Department"), but must repay any such borrowings by reclaiming funds paid to shareholders and unsecured creditors, and, if such funds are insufficient, levying risk-based assessments on large bank holding companies and nonbank financial companies.

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

Title III is largely devoted to eliminating the Office of Thrift Supervision ("OTS") and transferring its authorities to the other federal banking regulators. It consolidates federal supervision of insured state-chartered thrifts in the FDIC, gives the Office of the Comptroller of the Currency ("OCC") supervisory authority over all federal thrifts, and gives the Federal Reserve authority over thrift holding companies and their nondepository subsidiaries. Among other things, the OCC is permitted to charter and regulate new thrifts (also called savings associations). Title III's FDIC reforms include substantial revenue-raising provisions intended to offset costs of the Act (and to replace in part the controversial "bank tax" that had been negotiated at the last minute by the Conference Committee), as well as FDIC governance provisions.

D. Title IV: Regulation of Advisers to Hedge Funds and Others

Title IV of the Act expands Securities and Exchange Commission ("SEC") registration requirements to cover advisers to most "private funds." The registration requirements will apply to advisers with at least $25 million in assets under management, but only where states do not require their registration. The SEC will require registration of covered private funds with at least $100 million in assets under management. Managers of venture capital funds (as defined by the SEC) will be exempt from registration and family offices (as defined by the SEC) will be excluded from the definition of investment adviser.

E. Title V: Insurance

This title establishes a new Federal Insurance Office ("FIO") within the Treasury Department and gives it the authority to perform a number of tasks relating to all lines of insurance other than health insurance. It also includes a number of state-based reforms of nonadmitted insurance and reinsurance.

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

Title VI makes a number of changes to the regulation of banks and thrifts and their holding companies in order to reduce risks to US financial stability, including the imposition of capital requirements on bank and thrift holding companies. This title implements a compromise version of the "Volcker Rule," generally barring proprietary trading and hedge fund or private equity fund sponsorship by banking entities but providing a series of exceptions that allow some of these activities to continue.

G. Title VII: Wall Street Transparency and Accountability

Title VII of the Act is devoted to the over-the-counter ("OTC") derivatives market and subjects almost all swaps and security-based swaps to regulation. Most notably, almost all swaps are required to be cleared through a derivatives clearing organization or a clearing agency (collectively, a "DCO") and traded on an exchange or alternative execution facility. Any swap entered into by a major swap participant or swap dealer – which includes virtually any significant market actor – will generally not be exempt from clearing. There are substantial registration, recordkeeping, and reporting requirements for DCOs, swap repositories, exchanges and alternative execution facilities, as well as for major swap participants and swap dealers. Exemptions from the definitions of major swap participant and swap dealer and from clearing requirements are narrow, but include an exemption for end users who are not financial entities and are using swaps to hedge or mitigate risk. Jurisdiction over the OTC derivatives markets is divided between the Commodity Futures Trading Commission ("CFTC") and the SEC with the former having jurisdiction over swaps and the latter over security-based swaps. Federal bank regulators are responsible for prudential oversight over market participants that are subject to US banking regulation.

The Conference Committee reached a compromise on the highest-profile and most contentious section of the Act, which requires banking entities to "push out" a large proportion of their derivatives operations into nonbank affiliates. However, under the compromise, banks generally will be allowed to retain their derivatives operations as long as they are hedging or mitigating risk, or trading interest rate or foreign exchange swaps.

H. Title VIII: Payment, Clearing and Settlement Supervision

This title of the Act addresses the importance of clearing and settlement infrastructure systems to the financial system and authorizes the Federal Reserve, the SEC, and the CFTC to prescribe risk management standards for the conduct of "systemically important" payment, clearing and settlement activities by financial market utilities and financial institutions, including broker-dealers, investment advisers, and investment companies.

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

Title IX (the "Investor Protection Title") addresses a wide range of issues relating to the functioning of securities markets and the operation of the SEC. Organized into 10 subtitles, it contains a number of fairly contentious provisions, including the possible extension of a fiduciary duty to broker-dealers, increased civil liability for credit rating agencies, and enhanced liability and enforcement tools.

Subtitle A: Increasing Investor Protection. Among other things, Subtitle A establishes an Investor Advisory Committee and an Office of the Investor Advocate. It clarifies the SEC's authority to engage in investor testing, streamlines filing procedures for self-regulatory organizations ("SROs"), authorizes the SEC to issue point of sale disclosure rules, and requires a number of studies. Most notably, it requires an SEC study within six months of enactment of the Act on expanding the duty of care currently applicable to

investment advisers to cover broker-dealers that provide personalized investment advice to retail investors. The SEC is authorized to promulgate rules at the end of the study.

Subtitle B: Increasing Regulatory Enforcement and Remedies. This subtitle generally expands the jurisdiction and enforcement authority of the SEC, subjects violators to new and enhanced penalties, and increases the collateral consequences for "bad actors." In addition it gives the SEC authority to prohibit, limit, or place conditions on mandatory predispute arbitration agreements.

Subtitle C: Improvements to the Regulation of Credit Rating Agencies. Subtitle C includes a number of modifications to oversight of credit rating agencies, including additional internal controls over the ratings process, a new civil liability provision, and a mandate for federal agencies to remove ratings references from their rules.

Subtitle D: Improvements to the Asset-Backed Securitization Process. Subtitle D, the so-called "skin in the game" section of the Act, defines asset-backed securities ("ABS") broadly and requires that the regulators impose an unhedged risk retention requirement on securitizers of ABS, subject to broad exemptive authority.

Subtitles E and G: Accountability and Executive Compensation and Strengthening Corporate Governance. These subtitles include new standards relating to corporate governance, executive compensation, and disclosure. These provisions are not limited to financial services firms. The subjects covered by the subtitles include SEC authority to adopt proxy access rules; shareholder say-on-pay and "say-on-parachute" votes; compensation committee and compensation consultant independence; "clawbacks" of erroneously awarded executive compensation; disclosure requirements concerning CEO/board chair structure, relationship of pay to performance, ratio of CEO compensation to employee compensation, and hedging of company securities; and prohibition of "broker non-votes" for uncontested director elections, executive compensation and other significant matters.

In addition, federal regulators are directed to promulgate regulations requiring most financial institutions to disclose their incentive-based compensation structures to the appropriate regulator and prohibiting compensation structures that the regulators determine encourage inappropriate risks by providing excessive compensation or that could lead to material financial loss.

Subtitle F: Improvements to the Management of the SEC. This subtitle addresses the SEC's internal processes and directs the agency to engage in rulemaking, create new offices, and otherwise improve its internal operations. It requires a number of new reports, as well as an independent consultant study on the SEC's organizational structure and a "revolving door" study. It also expands the duties of the SEC's Inspector General.

Subtitle H: Municipal Securities. This subtitle imposes a number of reforms on the municipal securities market, including new registration and regulation requirements for participants and changes to the composition of the Municipal Securities Rulemaking Board ("MSRB").

Subtitle I: Public Company Accounting Oversight Board, Portfolio Margining, and Other Matters. Among other things, this subtitle expands the regulatory authority of the Public Company Accounting Oversight Board ("PCAOB") to cover accounting firms that audit non-public broker-dealers. It also exempts smaller public company issuer from the Sarbanes-Oxley Act requirement for an audit of internal control over financial reporting. It also contains provisions relating to protection of seniors, loans and borrowing of securities, proprietary trading, inspectors general, and fixed income annuities.

Subtitle J: SEC Match Funding. The SEC will continue to be subject to the appropriations process but with some modifications that will increase its resources and provide it with access to a new "Reserve Fund" from which it can draw as necessary to carry out its functions.

J. Title X: Bureau of Consumer Financial Protection

Title X establishes the Bureau of Consumer Financial Protection ("Bureau") as an autonomous agency within the Federal Reserve that concentrates rulemaking, supervision and powerful new enforcement tools for consumer protection in a single agency to a degree never before seen in the federal financial regulatory scheme. The Bureau exercises exclusive rulemaking authority over nearly all major federal consumer financial services laws and enjoys broad powers to supervise and enforce such laws over many providers of financial products and services. The Bureau's primary supervisory and enforcement powers extend to depository institutions with over $10 billion in assets and certain non-depository institutions such as providers of mortgage-related services, larger participants of a market for financial services, and certain others. The Bureau also has a secondary role in supervising smaller depository institutions, which generally remain subject to the jurisdiction of their prudential regulators. Title X also affords a broader scope for the application of state consumer protection law to federally-chartered depository institutions and their subsidiaries by establishing more stringent statutory tests and procedures for the application of federal preemption. Finally, Title X incorporates new rules regulating remittance providers, requires that interchange rates payable by merchants for electronic debit transactions be "reasonable and proportional" to the cost of the payment network, and requires persons taking adverse action against a consumer to provide applicants with their numerical credit score.

K. Title XI: Federal Reserve System Provisions

Title XI grants the Federal Reserve and the FDIC substantial economic stabilization powers, but only for use in broad-based programs. The powers may not be used to assist individual financial firms and must meet a number of policy, procedural, and regulatory controls. These economic stabilization powers are also subject to measures providing for transparency.

L. Title XII: Improving Access to Mainstream Financial Institutions

Title XII creates programs to assist low- and moderate-income individuals to establish deposit and other accounts with mainstream financial institutions, such as banks and credit unions. The title aims to encourage low-cost alternatives to high-cost small dollar loans (such as payday loans) and provides for the potential for grants to subsidize the offering of such alternatives to certain eligible entities.

M. Title XIII: Pay it Back Act

This title shortens the life of and reduces the amount available to the Secretary of the Treasury under the Troubled Asset Relief Program ("TARP"). It also requires that all Fannie Mae, Freddie Mac, and Federal Home Loan Bank obligations or securities sold by the Treasury Department must be used to reduce the deficit.

N. Title XIV: Mortgage Reform and Anti-Predatory Lending Act

Title XIV enacts various consumer protections for residential mortgages and strengthens underwriting by prohibiting creditors generally from extending residential mortgages to borrowers who cannot demonstrate through documentary evidence a reasonable ability to repay the loan. Title XIV also bans a variety of residential mortgage lending practices, including certain balloon payments and prepayment fees, and anything, without apparent limit, that the Bureau of Consumer Financial Protection determines to be abusive, unfair, deceptive, predatory, or not in the interest of the borrower. The title imposes further restrictions on mortgages that are not deemed "qualified," defined as meeting certain pro-consumer requirements concerning interest rates, fees, and terms. Title XIV also bans certain practices in mortgage origination, imposes new requirements on mortgage servicers, establishes standards for property appraisals, and places conditions on certain high-cost and higher-risk mortgages.

O. Title XV: Miscellaneous Provisions

This title contains a number of miscellaneous provisions including, among other things, provisions limiting the use of US support for International Monetary Fund ("IMF") loans that are unlikely to be repaid, improving transparency of payments regarding commercial development of oil, gas, and minerals, and requiring

disclosure of due diligence efforts related to the use of minerals originating in the Congo. Also included are provisions relating to the differences between inspectors general appointed by the President and those appointed by their agency.

P. Title XVI: Section 1256 Contracts

The final title of the Act seeks to ensure that certain swaps that will be required to be exchange-traded will not be treated as Section 1256 contracts under the Internal Revenue Code, which requires that covered contracts be marked to market at the end of each tax year so that their gain or loss is recognized each year.

III. DISCUSSION

A. Title I: The Financial Stability Act of 2010

Title I of the Act establishes a broad regulatory framework to protect the US financial system from the systemic risks posed by certain financial companies and activities.

1. The Financial Stability Oversight Council

The key feature of the new framework is the Financial Stability Oversight Council, to be formed upon the Act's enactment, which has 10 voting and five nonvoting members. The Council's Chairperson is the Secretary of the Treasury; the other voting members are the heads of the Federal Reserve, the OCC, the Bureau, the SEC, the FDIC, the CFTC, the Federal Housing Finance Agency ("FHFA"), and the National Credit Union Association ("NCUA"), along with an independent insurance expert appointed by the President. The nonvoting members are the heads of the Office of Financial Research ("OFR") and the FIO, as well as a state insurance commissioner, banking supervisor, and securities regulator designated through industry-determined selection processes. Unless otherwise specified, the Council decides by majority vote.

The Council has three broad aims: (1) identifying risks to US financial stability that could arise from the material financial distress or failure, or ongoing activities, of large interconnected bank holding companies or certain nonbank financial companies, or that could arise outside the financial services marketplace; (2) promoting market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties that the government will shield them from losses in the event of failure; and (3) responding to threats to the stability of the US financial system. To meet these obligations, the Council, among other things, is to collect information needed to assess risks; monitor the financial services marketplace to identify potential threats to US financial stability; identify regulatory gaps that could pose risks to financial stability; require the Federal Reserve to supervise nonbank financial companies whose distress, failure, or activities might threaten financial stability; recommend heightened prudential standards for large interconnected bank holding companies and systemically significant nonbank financial companies; identify systemically important financial market utilities and payment, clearing, and settlement activities; recommend new or heightened prudential standards to primary financial regulators; and review and recommend federal accounting standards.

To support the Council, the Act establishes the OFR, whose main roles are to collect data and research the financial system. It is also tasked with standardizing the data reported to the Council and developing tools for measuring and monitoring risk. The Director of the OFR must provide an annual report and testimony to the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Financial Services on the activities of the OFR, significant financial market developments, and potential threats to US financial stability.

2. Designation of Systemically Important Companies

One of the Council's key powers is its ability to determine that a nonbank financial company poses a threat to US financial stability and should therefore be supervised by the Federal Reserve and subject to prudential standards. A "nonbank financial company," which may be US or non-US, is a company that is predominantly engaged in financial activities. Under the Pryor-Vitter Amendment, a company is

"predominantly engaged in financial activities" if either 85% of the annual gross revenues or 85% of the consolidated assets of the company and its subsidiaries are financial in nature (and, if applicable, related to the ownership or control of one or more insured depository institutions). Whether activities are "financial in nature" is determined under the Bank Holding Company Act.

To make this determination, two-thirds of the Council's voting members, including the Secretary of the Treasury, must affirmatively vote that material financial distress at the company or the nature, scope, size, scale, concentration, interconnectedness, or mix of activities of the company could threaten US financial stability. (These standards were expanded in Conference to include risks based on a company's activities, not just its material financial distress.) The Council is to consider a number of factors, including: the company's leverage; its off-balance sheet exposures; its interconnectedness with other significant nonbank financial companies and bank holding companies; its importance as a source of credit in low-income and underserved communities; its liabilities (including its reliance on short-term funding); whether it is already regulated by one or more primary financial regulatory agencies (i.e., the Federal banking regulators, SEC, CFTC, state insurance agencies, and the Federal Housing Finance Agency) or, in the case of a foreign company, whether it is subject to prudential standards on a consolidated basis, which standards are administered and enforced by a comparable foreign supervisory authority; its financial assets; and the extent to which assets are managed rather than owned by the company and the ownership of such assets is diffuse. The concern about reliance on short-term funding was added in Conference. Under the "Hotel California" provision, any existing or former bank holding company (and any successor nonbank entity thereof) that has or had consolidated assets of at least $50 billion as of January 2010 and that received TARP assistance is to be treated as a nonbank financial company subject to Federal Reserve supervision under this title as if the Council had made the determination. These companies may appeal this status.

The Council may also determine, again by a two-thirds vote including an affirmative vote by the Secretary of the Treasury, that a US or non-US company has been organized or operates in such a way as to evade the Council's authority and that such company's financial distress related to its financial activities, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the company's financial activities, would threaten US financial stability. (Again, these standards were expanded in Conference from those in the Senate bill to include risks based on a company's activities, not just its material financial distress.) This anti-evasion determination may be made at the Council's initiative or the Federal Reserve's request. A company that has been determined to be operating to evade these requirements may decide to, or the Federal Reserve may mandate that it, form an intermediate holding company for its financial activities, subject to Federal Reserve supervision and regulation. The Federal Reserve also has the authority to require any systemic nonbank financial company to form an intermediate holding company to facilitate the Federal Reserve's supervision of the company's financial activities and to ensure that this supervision does not extend to the company's commercial activities. The Act requires a company that directly or indirectly controls such an intermediate holding company to serve as a source of strength to the intermediate holding company and brings the company under the enforcement provisions of Section 8 of the Federal Deposit Insurance Act. The Federal Reserve may require the controlling company of an intermediate holding company to provide it with reports to ensure that it can act as a source of strength.

In all cases, these determinations must be made in consultation with any relevant primary financial regulator and are subject to notice and a hearing. A determination that a nonbank financial institution, or the financial activities of any other company, are subject to Federal Reserve supervision, is subject to judicial review, as well as to annual re-evaluation. Additionally, only the financial activities of the companies are subject to the Federal Reserve's supervision and prudential standards.[4]

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[4] The Council has additional authorities under other Titles as well. For example, under Section 716, the "Push-Out Rule," the Council may, if necessary to mitigate systemic risk and protect taxpayers, prohibit federal assistance to swaps entities. In addition, if the SEC and CFTC cannot jointly produce swaps regulations, the Council is required to issue new rules. *See* discussion of Title VII, below.

3. *Recommendation of Prudential Standards*

Another important tool the Act grants the Council is the ability to recommend that the Federal Reserve establish and refine prudential standards and reporting and disclosure requirements applicable to nonbank financial companies supervised by the Federal Reserve (as described above) and large, interconnected bank holding companies (already subject to Federal Reserve supervision). These standards and requirements are to be more stringent than those applicable to other, less risky, nonbank financial companies and bank holding companies. In these recommendations, the Council may differentiate among companies based on individual- or industry-level risks or may increase the asset threshold for applying the standards above the $50 billion set in the corresponding Federal Reserve provisions, discussed below.

The Council may recommend that the Federal Reserve issue standards for: risk-based capital requirements; leverage limits; liquidity requirements; the submission of a resolution plan and credit exposure reports to the Council, Federal Reserve, and FDIC; concentration limits (as discussed in more detail below); contingent capital requirements (after first studying the feasibility of such requirements within the two years after the enactment of the Act); enhanced public disclosures to support market evaluations of the company's riskiness; short-term debt limits; and overall risk management. The Act gives the Federal Reserve the ability to implement the Council's recommendations, as discussed below. Additionally, the Council may require a bank holding company with total consolidated assets of at least $50 billion or a nonbank financial company supervised by the Federal Reserve to report to the Council on the financial condition of the company and various other risk factors.

Similarly, after a notice and comment period, the Council may recommend additional standards and safeguards to the primary financial regulatory agencies for financial activities or practices conducted by bank holding companies or nonbank financial companies more generally. The primary regulator must either adopt these recommendations, or similar standards acceptable to the Council, within 90 days of the Council's recommendation, or explain why it has not done so. Where no primary regulator exists for the relevant entities or activities, the Council may recommend legislation to Congress. The Council may also recommend to any primary financial regulator that a financial activity no longer requires standards or safeguards implemented under a previous recommendation, though the primary regulators may choose to continue the regulations.

4. *Expansion of Federal Reserve Authority*

As noted above, Title I authorizes the Federal Reserve to subject the activities of nonbank financial companies under its supervision and large, interconnected bank holding companies to more stringent prudential standards and reporting and disclosure requirements. The Federal Reserve shall, on its own or pursuant to the Council's recommendations discussed above, establish prudential standards for nonbank financial companies supervised by the Federal Reserve and bank holding companies with total consolidated assets equal to or greater than $50 billion. As with the corresponding provisions applicable to the Council, these standards and requirements are to be more stringent than those applicable to other, less risky, nonbank financial companies and bank holding companies. In establishing the standards, the Federal Reserve—like the Council—may differentiate among companies based on individual- or industry-level risks or apply them at an asset threshold of more than $50 billion.

The Act mandates that the Federal Reserve establish, for nonbank financial companies it supervises and bank holding companies with total consolidated assets equal to or greater than $50 billion: risk-based capital requirements and leverage limits; liquidity requirements; overall risk management requirements; submission of a credible resolution plan; credit exposure report requirements; and concentration limits. A company's failure to submit a credible resolution plan to the Federal Reserve and the FDIC could lead to the forced divestiture of certain assets or operations to facilitate an orderly resolution of the company under Title II, if such company later fails. The mandated concentration limits must prohibit these companies from having credit exposure to any unaffiliated company exceeding 25% (or a Federal Reserve-determined lesser percentage) of the capital stock and surplus of the company.

As a general matter, companies may be exempted from the capital requirements and leverage limits if the Federal Reserve, in consultation with the Council, determines that the requirements are inappropriate because of the activities of the company (such as investment company activities or assets under management) or the company's structure; the Federal Reserve is then required to establish other standards resulting in similar risk controls. However, for companies (other than Federal Home Loan Banks) that the Council determines pose a grave threat to US financial stability and for whom a leverage standard is determined necessary to mitigate this threat, the Federal Reserve must require them to maintain a debt-to-equity ratio of no more than 15 to 1. Furthermore, the Federal Reserve may implement, for nonbank financial companies that it supervises, additional capital requirements and other activity restrictions for proprietary trading, hedge fund investments, and private equity fund investments, because these companies are not subject to the Volcker Rule in Title VI (*see* discussion of Title VI, below). With respect to the computation of capital for meeting the risk-based capital requirements, the Federal Reserve must require that companies include off-balance sheet activities that may, upon a future event, become a balance sheet liability.

For these same institutions, the Federal Reserve is also authorized to implement additional standards, including a contingent capital requirement (subsequent to the Council report discussed above), enhanced public disclosures, short-term debt limits (including off-balance sheet exposures, but not including insured deposits), and other prudential standards as it, on its own accord or pursuant to a Council recommendation, determines appropriate. If these standards would have a significant impact on a functionally-regulated or depository institution subsidiary of a Federal Reserve-supervised nonbank financial institution or bank holding company, the Federal Reserve must consult with each Council member that primarily supervises the subsidiary. The inclusion of short-term debt limits (including off-balance sheet exposures) occurred in Conference and may affect a company's traditional issuance of commercial paper.

The "Collins Amendment" included in the Senate Bill was retained in Conference and requires the appropriate Federal banking agencies to establish minimum leverage capital and risk-based capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Federal Reserve. The requirements may not be less than the generally-applicable risk-based capital and leverage capital requirements, and may not be quantitatively lower than the requirements in effect for insured depository institutions as of the enactment of the Act. The generally-applicable risk-based capital and leverage capital requirements refer to the requirements established by the federal banking agencies for insured depository institutions under the prompt corrective action provisions of the Federal Deposit Insurance Act. Although not stated clearly in the Act, it is understood that references to the phase-in of "regulatory capital deductions" refers to the inclusion of hybrid securities, including trust-preferred securities (but not including TARP-preferred securities), in the calculation of Tier 1 capital. Depository institution holding companies with total consolidated assets of less than $15 billion are exempt, as are the Federal Home Loan Banks, mutual holding companies, and small bank holding companies. This provision is effective as of May 19, 2010 for all debt or equity instruments issued on or after May 19, 2010 and phased in over a three year period beginning on January 1, 2013 for all debt or equity instruments issued before May 19, 2010. For depository holding companies not subject to supervision by the Federal Reserve as of May 19, 2010, the requirements are effective five years after the date of enactment of the Act. Additionally, the Government Accountability Office ("GAO") is to issue a report on hybrid capital instruments as a component of Tier 1 capital within 18 months after the enactment of the Act.

Under the Collins Amendment, capital rules must address the risks that a company's activities pose to itself and to other public and private stakeholders in the event of adverse performance, disruption, or failure of the company or the activity, subject to the recommendations of Council discussed above. More specifically, the Act requires that the rules address, at a minimum, the risks arising from: significant volumes of activity in derivatives, securitized products purchased and sold, financial guarantees purchased and sold, securities borrowing and lending repurchase agreements, and reverse repurchase agreements; concentrations in assets for which the values presented in financial reports are based on

models rather than historical cost or prices deriving from deep and liquid two-way markets; and concentrations in market share for any activity that would substantially disrupt financial markets if the company is forced to unexpectedly cease the activity. US bank holding company subsidiaries of foreign banking organizations are subject to these requirements five years after the enactment of the Act.

The Act requires the Federal Reserve to conduct annual stress tests on bank holding companies with total consolidated assets of $50 billion or more and nonbank financial companies that it supervises to determine the sufficiency of the company's consolidated capital to absorb losses resulting from adverse economic conditions. These institutions must also conduct their own stress tests semiannually. All other financial companies with total consolidated assets of more than $10 billion that are regulated by a primary Federal financial regulatory agency must also conduct annual stress tests.

Additionally, the Federal Reserve is required to consult with the Council and the FDIC to issue regulations for the early remediation of financial distress by a bank holding company with total consolidated assets equal to or greater than $50 billion or a nonbank financial institution the Federal Reserve supervises. The relevant section of the Act explicitly states that the section does not authorize Federal financial assistance. The Federal Reserve is authorized under the Act to require the nonbank financial companies that it supervises to report on their financial condition and other risk factors. It is also authorized to examine any nonbank financial company supervised by it, although it shall coordinate these examinations with the relevant primary Federal financial regulatory agencies and rely, if possible, on existing reports by such agencies.

The Federal Reserve may also, if the Council affirms by a two-thirds vote including the Secretary of the Treasury's vote, determine that a bank holding company with total consolidated assets of $50 billion or more or a nonbank financial company supervised by it poses a grave threat to US financial stability and warrants mitigatory action. Upon this determination, which is subject to notice and a hearing, the Federal Reserve is to limit the ability of the company to merge with, acquire, consolidate with, or otherwise affiliate with another company; restrict the ability of the company to offer financial products; terminate its activities; impose conditions on its manner of doing activities; and, if the Federal Reserve determines that the above actions are inadequate to mitigate the threat, sell or otherwise transfer assets or off-balance-sheet items to unaffiliated entities.

Nonbank financial companies the Federal Reserve supervises will be subject to the applicable Section 8 enforcement provisions of the Federal Deposit Insurance Act, in the same manner and to the same extent as if the company were a bank holding company. The Federal Reserve may recommend supervisory or enforcement actions to primary regulators of depository institution or functionally regulated subsidiaries of nonbank financial companies, and may exert back-up supervisory or enforcement authority where the primary financial regulator does not act on such a referral.

For purposes of the acquisition of bank shares or assets, a nonbank financial company supervised by the Federal Reserve is deemed to be, and is treated as, a bank holding company. Additionally, any bank holding company with total consolidated assets of at least $50 billion or any nonbank financial company the Federal Reserve supervises must provide notice to the Federal Reserve before acquiring direct or indirect ownership or control of any voting shares of any company described in Section 4(k) of the Bank Holding Company Act having at least $10 billion in total consolidated assets. A nonbank financial company supervised by the Federal Reserve is also to be treated as a bank holding company for purposes of the Depository Institutions Management Interlocks Act, although the Federal Reserve may not allow a manager of a nonbank financial company that it supervises to manage any large, interconnected bank holding company or any other nonaffiliated nonbank financial company that it supervises.

Finally, Title I was amended in Conference to require that the risk to the financial stability of the US be considered when establishing a foreign bank or foreign broker-dealer office in the US and as a rationale for terminating any such offices in the US.

B. Title II: Orderly Liquidation Authority

Title II establishes orderly liquidation authority as an alternative to bankruptcy when the collapse of a failing bank holding company or nonbank financial company poses serious risks to the financial system. This authority seeks to provide the government with tools to allow for smoother resolution of systemically-important firms than current law allows for by modeling the new orderly liquidation authority on the existing powers of the FDIC to resolve insured depository institutions, with certain adjustments that more closely follow the provisions of the US Bankruptcy Code. All financial companies put into receivership under Title II will be liquidated and no taxpayer funds may be used to prevent the liquidation of any financial company. All funds expended in the liquidation must be recovered from the disposition of assets of the financial company or shall be the responsibility of the financial sector, through after-the-fact assessments. Taxpayers are protected from losses from the exercise of this authority.

Orderly liquidation authority utilizes the FDIC as receiver to liquidate failing companies, but will be available only under limited circumstances.

1. Systemic Risk Determination

A systemic risk determination must be made before orderly liquidation authority can be invoked. Generally, two-thirds of the Federal Reserve and of the FDIC must approve a written recommendation that orderly liquidation of a financial company is necessary. For brokers or dealers, two-thirds of the Federal Reserve and of the SEC, in consultation with the FDIC, must approve the written recommendation. For insurance companies, the Director of the FIO, in consultation with the FDIC, and two-thirds of the Federal Reserve must approve the recommendation. The recommendation must evaluate the impact that default of the financial company would have on economic conditions and financial stability in the US; on low income, minority, and underserved communities; and on creditors, counterparties, and shareholders of the financial company and other market participants. The recommendation must state whether a private sector alternative could prevent the default and explain why bankruptcy is not appropriate.

Authorization of orderly liquidation will proceed if, upon receipt of the recommendation, the Secretary of the Treasury, in consultation with the President, determines that the company is in danger of default, that default of the company would have serious adverse effects on financial stability in the US, and that there is no viable private sector alternative. Among other things, the Secretary of the Treasury must also find that the effects on creditors, counterparties, and shareholders of the financial company and other market participants are outweighed by financial stability concerns, and affirm that the company qualifies as a financial company under the Act. Under the Act, a financial company is a bank holding company, a nonbank financial company supervised by the Federal Reserve, a company predominantly engaged in financial activities, or any subsidiary of any such companies primarily engaged in financial activities.

2. Judicial Review

Once the Secretary of the Treasury has made these determinations, he or she must inform the FDIC and the financial company. If the company agrees, the Secretary of the Treasury will appoint the FDIC as receiver. If the company does not agree, the Secretary of the Treasury must file a petition under seal to obtain judicial approval to appoint the FDIC as receiver. After notice to the financial company and an opportunity for a hearing (on a confidential basis), the US District Court for the District of Columbia has 24 hours to decide whether one or both of the determinations of the Secretary of the Treasury – that the company (1) is a financial company and (2) is in danger of default – are arbitrary and capricious. Upon such a determination, the court may prevent the Secretary of the Treasury from appointing the FDIC as receiver. If the court does not make such a determination, or does not issue an order within 24 hours, the Secretary of the Treasury will appoint the FDIC as receiver and the company will be liquidated. If the court makes a finding of arbitrary and capricious, however, it must immediately provide the Secretary of the Treasury with a written statement of its reasons and allow for an opportunity for an amended petition. The district court's decision is subject to an expedited appeal to the US Court of Appeals for the DC

Circuit. The appeal is limited to a review of the district court's arbitrary and capricious determinations. No stay or injunction is available pending appeal. Similar provisions govern appeal to the Supreme Court.

3. FDIC Receivership

The FDIC may only serve as receiver for three years, with two possible one year extensions available if necessary to maximize value, minimize losses, or protect national financial stability. Further extensions are only available to complete ongoing litigation. The FDIC is not liable for unresolved claims once it is no longer receiver.

Under orderly liquidation, creditors and shareholders will bear the losses of the financial company. All parties, including management and third parties, will bear losses commensurate with their level of responsibility, including damages, restitution, and compensation recovery. No management responsible for the condition of the company will be retained.

4. Coordination with SIPC

The FDIC will consult with the primary regulators of any not-covered subsidiaries and coordinate with the SEC and the Securities Investor Protection Corporation ("SIPC") when appropriate. If the FDIC is appointed receiver for a broker or dealer, the FDIC's orderly liquidation process will proceed simultaneously with SIPC's customer protection processes. The appointment of the FDIC as a receiver or SIPC as a trustee under this Act precludes proceedings under the Bankruptcy Code or the Securities Investor Protection Act of 1970.

5. Orderly Liquidation Fund

The FDIC will establish the Orderly Liquidation Fund. The FDIC may borrow from the Secretary of the Treasury in limited quantities for the Fund when needed to cover the costs of an orderly liquidation. All amounts borrowed from the Treasury Department must be repaid by recovering claims paid to shareholders, unsecured creditors, and (if necessary) levying risk-based assessments against other financial institutions. The FDIC must submit a plan for each orderly liquidation to the Treasury Department which describes the plan for repaying borrowed funds. The FDIC may levy risk-based assessments against bank holding companies with at least $50 billion in assets and any nonbank financial company supervised by the Federal Reserve. Firms with greater assets or greater risk will be assessed at higher rates.

6. Director and Officer Liability

A director or officer of a covered financial company may be held personally liable for monetary damages in a civil action for gross negligence or a disregard of a duty of care exceeding gross negligence, including intentional torts under state law. The claims must be brought by, on behalf of, or at the request or direction of the FDIC.

Senior executives or directors of a covered financial company may be barred from involvement in a financial company for two years or more. The bar may be imposed by the Federal Reserve, or by the FDIC if the Federal Reserve was not the regulator of the financial company. Senior executives or directors may be subject to the bar if they are found to have violated a law, regulation, fiduciary duty, or certain other commitments. If a senior executive or director experienced financial gain or benefit from such conduct, and undertook the conduct dishonestly or with disregard for the safety and soundness of the company, that person will be subject to a bar of at least two years as determined by the Federal Reserve or FDIC.

7. Qualified Financial Contracts

Parties to qualified financial contracts are generally entitled to exercise their rights under the contracts. There is an automatic stay of the exercise of those rights until the earlier of (1) one business day following the appointment of the FDIC as receiver, or (2) the time at which notice is received that the contract has

been transferred by the FDIC to another financial institution. The stay prevents exercise of the right to terminate, liquidate, or net the qualified financial contract "solely by reason of or incidental to the appointment" of the FDIC as receiver.

If a covered financial company has qualified financial contracts cleared by or subject to the rules of a clearing organization, the FDIC must use its best efforts to meet the obligations of the covered financial company to the clearing organization.

The FDIC has the power to enforce subsidiary contracts guaranteed by a covered financial company despite cross-default provisions triggered by the guarantor's default, if the guarantee and related transactions are transferred to a bridge financial company or third party acquirer.

8. Reports and Studies

The Inspectors General of the FDIC, Treasury Department, and appropriate primary regulator are all required to conduct reviews of the use of orderly liquidation authority within six months of the appointment of the FDIC as receiver and every six months thereafter.

In addition, various studies are commissioned, including:

- a study by the Council of the potential use of secured creditor haircuts to improve market discipline and protect taxpayers in a resolution process;
- a study by the GAO of prompt corrective action implementation by federal banking regulators;
- a study by the Administrative Office of the US Courts and the GAO of the effectiveness of the bankruptcy and orderly liquidation process for resolving financial companies; and
- a study by the GAO of international coordination relating to the bankruptcy process for financial companies.

C. Title III: The Enhancing Financial Institution Safety and Soundness Act of 2010

Title III is largely devoted to eliminating the OTS and transferring its authorities to the other Federal banking regulators. The OTS currently charters federal thrifts and regulates and supervises state and federal thrifts and thrift holding companies. The Act transfers two OTS roles to the Federal Reserve, which currently regulates state-chartered banks that are members of the Federal Reserve System and bank holding companies and financial holding companies on a consolidated basis: the OTS's functions and powers over savings and loan holding companies and their nondepository subsidiaries, and rulemaking authority over savings and loan holding companies under Sections 11 (transactions with affiliates) and 5(q) (tying arrangements) of the Home Owners' Loan Act ("HOLA"). Under the Act, the OCC, which currently charters and supervises national banks, takes on the OTS's power to charter and regulate federal thrifts, as well as rulemaking authority over savings associations. While the Senate Bill abolished new federal thrift charters, Senator Dodd and Representative Frank agreed to adopt proposed House language allowing new federal thrift charters in the conference base text. Within the OCC, a new Deputy Comptroller is responsible for supervising and examining federal savings associations. Finally, the Act transfers all OTS functions relating to state savings associations to the FDIC, which currently insures the deposits of state and federal banks and thrifts, and is the primary federal regulator of state-chartered banks that are not members of the Federal Reserve System.

This transfer of powers is to take place within one year of the enactment of the Act, though this deadline can be extended by six months by the Secretary of the Treasury in consultation with the OTS, the Federal Reserve, the OCC, and the FDIC. The OTS must close within 90 days after the transfer. In preparation for the transfer, the Federal Reserve, the OCC, the FDIC, and the OTS are to submit a plan for the transfer to Congress and the Inspectors General of the relevant federal banking agencies. Under the Act, lawsuits

or actions against the OTS may continue against the entity that assumes the relevant functions or powers, and all OTS orders, resolutions, determinations, agreements, and regulations, interpretative rules, other interpretations, guidelines, procedures, and other advisory material continue in effect and are to be enforced by the entity that assumes the relevant OTS functions and powers. By the transfer date, the Federal Reserve, OCC, and FDIC must each specify the OTS regulations that it shall enforce; the OCC and FDIC must consult with each other through this process.

Title III also clarifies that savings associations that convert to national banks may continue to operate any branch or agency that the savings association operated immediately before the conversion. Similarly, savings associations may establish, acquire, and operate branches and agencies within any state in which the savings association operated a branch immediately before its conversion to a national bank, but only if the such states would permit the establishment of a branch by a state bank.

Title III's FDIC reforms include substantial revenue-raising provisions intended to offset costs of the Act, as well as FDIC governance provisions. In a reopening of the House-Senate conference after Senator Brown expressed concerns regarding the last minute addition of a "bank tax" to finance the Act, the Act was changed to increase the minimum reserve ratio for the Deposit Insurance Fund to at least 1.35 percent of estimated insured deposits, or a comparable percentage of the revised assessment base, up from the current 1.15 percent. The FDIC has until 2020 to meet this revised reserve ratio, and the increase is to be made up of premiums paid by insured depository institutions with total consolidated assets of $10 billion or more. The reopened Conference also determined to end the TARP early and to reduce the amount available to the Secretary of the Treasury for TARP programs. (*See* the discussion of Title XIII below). In addition, the Act revises the assessment base for bank premiums so that they are based on average total consolidated assets minus the average consolidated tangible equity during the assessment period. The assessment base for bankers' banks and custodial banks is further reduced by an amount to be determined by the FDIC. Currently, the assessment base is based on US deposits.

The Act also increases to $250,000 both the deposit insurance cap, retroactive to FDIC receiverships initiated on or after January 1, 2008, and the share insurance cap for federally insured credit unions. It extends the Transaction Account Guarantee program, providing for full FDIC insurance for the net amount that any depositor at an insured depository institution maintains in a noninterest bearing transaction account until January 1, 2013. Other provisions grant the FDIC more discretion in managing the Deposit Insurance Fund and the ability to suspend or limit dividend payments; increase the ability of the FDIC to collect information on conditions affecting insurance and requires it to collect information about the risk of loss and economic conditions; and replaces the Director of the OTS with the Director of the Bureau on the Board of Directors of the FDIC.

Finally, Title III establishes an Office of Women and Minority Inclusion within each departmental office of the Treasury Department, the FDIC, the Federal Housing Finance Agency, the Federal Reserve Banks, the Federal Reserve, the National Credit Union Administration, OCC, SEC, and the new Bureau. Each Office is responsible for matters relating to diversity in management, employment, and business activities, and for ensuring that agencies contract with minority-owned and women-owned businesses to the maximum extent possible.

D. Title IV: Regulation of Advisers to Hedge Funds and Others

To increase transparency for hedge funds, Title IV of the Act, the "Private Fund Investment Advisers Registration Act of 2010," expands SEC registration requirements to cover advisers to most "private funds."[5] Managers of venture capital funds will be exempt from registration. The SEC is required to define such funds for purposes of this title. The Conference debate, which centered largely on the need to exclude from the provisions of the Act those smaller funds that are focused on providing capital to small businesses, might provide some guidance for the SEC's rulemaking.

[5] Section 402(a) of the Act defines a "private fund" as "an issuer that would be an investment company, as defined in Section 3 of the Investment Company Act of 1940" ("Investment Company Act"), "but for Section 3(c)(1) or 3(c)(7) of that Act."

The registration requirements will continue to apply to advisers with at least $25 million in assets under management. States, which currently regulate only advisers with less than $25 million under management, will have responsibility for advisers with assets between $25 million and $100 million, but only for states that impose a registration requirement on those advisers. After the Conference process, Section 408 was expanded to include an SEC rulemaking to take into account the "size, governance and investment strategy" of mid-size private fund advisers (those with less than $150 million in assets under management in the US) when developing registration and examination requirements for those advisers. Family offices, as defined by SEC rule, will be excluded from the definition of investment advisers.

Among other things, Title IV imposes reporting and recordkeeping requirements on covered private fund advisers, to be determined by SEC rule, and also requires reporting of certain information to the Council for purposes of systemic risk monitoring and assessment, including information on the amount of assets under management, use of leverage, counterparty risk exposure, trading and investment positions, valuation policies, assets, side arrangements, trading practices, and other information. Section 416 requires a GAO study on the potential creation of a self-regulatory organization for private funds.

In addition, Title IV provides standards for custody of client assets by investment advisers and requires a study on compliance costs associated with the SEC client custody rule. It also provides for adjustments to the definition of "accredited investor" under Regulation D and requires a study on the appropriate criteria for determining financial or other thresholds for accredited investor status.[6] Finally, Title IV requires an SEC study on short selling, including delivery of shares and reporting of short sales. Title IV is effective a year after enactment of the Act.

E. Title V: Insurance

1. Subtitle A: Office of National Insurance

Subtitle A of Title V establishes the FIO in the Treasury Department and gives it the authority to perform a number of tasks, advise the Secretary of the Treasury, and collect information from insurers and affiliates. The Director of the FIO is appointed by the Secretary of the Treasury. The authority of the FIO extends to all lines of insurance except health insurance, crop insurance, and certain types of long-term care insurance and its mandate includes: (1) monitoring all aspects of the insurance industry; (2) monitoring the extent to which underserved communities have access to afford insurance products; (3) recommending to the Council that an insurer be subject to regulation as a nonbank financial company supervised by the Federal Reserve; (4) assisting the Secretary of the Treasury to administer the Terrorism Insurance Program; (5) coordinating federal efforts and developing federal policy on prudential aspects of international insurance matters; (6) determining whether a state insurance measure is preempted to the extent that it results in less favorable treatment to a non-US insurer domiciled in a foreign country that is subject to an international insurance agreement on prudential measures than a US insurer domiciled, licensed, or otherwise admitted in that state; and (7) consulting with state insurance regulators regarding insurance matters of national importance and prudential matters of international importance. To carry out its functions, the FIO is authorized to collect data from insurers and affiliates.

There is a savings provision that protects various existing state laws from preemption by the FIO. The FIO must submit a report annually to Congress regarding its exercise of this preemption authority, and must submit a report to Congress 18 months after the enactment of the Act on how to modernize and improve the system of insurance in the US. The Secretary of the Treasury and the US Trade Representative are authorized jointly to negotiate and enter into International Insurance Agreements on Prudential Matters on behalf of the US.

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[6] Currently, to qualify for "accredited investor" status under Rule 501 of Regulation D under the Securities Act, natural persons can include the value of their primary residence in their computation of net worth. Section 413 of the Act requires natural persons, individually or with their spouse, to have a net worth of $1 million, excluding the value of the primary residence. It also requires the SEC to review this definition and adjust it as necessary.

2. Subtitle B: State-Based Insurance Reform

Subtitle B of Title V involves state-based insurance reform of nonadmitted insurance and reinsurance, and includes authorization of a study of the nonadmitted insurance market by the GAO. This subtitle also regulates credit for reinsurance and reinsurance agreements, and reinsurer insolvency. It has an unusual savings provision in Section 541 stating that nothing is intended to modify, impair, or supersede the antitrust laws, and any implied or actual conflict will be resolved in favor of the antitrust laws, as well as a severability clause. Subtitle B has been changed only slightly from the Senate Bill.

F. Title VI: The Bank and Savings Association Holding Company and Depository Holding Company and Depository Institution Regulatory Improvement Act of 2010

Title VI makes a number of changes to the regulation of banks, thrifts, and their holding companies in order to reduce risks to US financial stability, including the imposition of capital requirements on bank and thrift holding companies and the establishment of the Volcker Rule.

1. Nonbank banks

So-called “nonbank banks” such as industrial loan companies, credit card banks, and trust banks, which are not treated as “banks” under the Bank Holding Company Act, are the subject of a number of regulatory changes. Most importantly, the Act imposes a three year moratorium (effective as of November 23, 2009) on the FDIC’s approval of deposit insurance for any industrial loan company, credit card bank, or trust bank that is owned or controlled, directly or indirectly, by a commercial firm. During this three year period, no change of control applications for industrial loan companies, credit card banks, and trust banks may be approved, absent an exception, if the change would result in a commercial firm taking direct or indirect control of the entity. A “commercial firm” is defined as any entity that derives less than 15 percent of its consolidated annual gross revenues, including revenues from all of its affiliates (including any insured depository institutions), from activities that are financial in nature or incidental thereto under the Bank Holding Company Act.

There are three exceptions to the general moratorium: (1) when an industrial, credit card, or trust bank is in danger of default; (2) when a change in control results from a bona fide merger with and into or an acquisition by a commercial firm of a commercial firm that controls an industrial, credit card, or trust bank; and (3) when a change in control results from an acquisition of voting shares of a publicly traded company that controls an industrial, credit card, or trust bank where the acquirer holds less than 25 percent of any class of the voting shares of the company. Exceptions are not permitted unless all regulatory approvals otherwise required under state and federal law have been obtained. Finally, the Act directs the GAO to study whether to eliminate the exceptions to the definitions of “bank” and “bank holding company” under the Bank Holding Company Act for credit card companies, industrial loan companies, trust banks, thrifts, and other limited purpose entities.

2. Enhanced Federal Reserve Authorities

As a complement to the Federal Reserve’s expanded authority provided by Title I of the Act for bank holding companies and nonbank financial companies supervised by the Federal Reserve, Title VI also expands the Federal Reserve oversight role. Pursuant to Title VI, the Act enables the Federal Reserve to obtain reports about functionally regulated subsidiaries of bank holding companies and thrift holding companies directly from functionally regulated subsidiaries of such holding companies. At the same time, however, the Federal Reserve must seek to use existing reports and information provided by the holding company or the subsidiary to other regulators. The Act also eliminates current limitations on the Federal Reserve’s ability to examine functionally regulated subsidiaries of bank and thrift holding companies, although this ability remains subject to the exclusive jurisdiction of the Bureau.

The Act also requires the Federal Reserve to examine non-depository institution subsidiaries (other than a functionally regulated subsidiary or a subsidiary of a depository institution) of a depository institution holding company engaging in activities permissible for insured depository institution subsidiaries of the

holding company. These examinations are to be undertaken in the same manner and frequency, and applying the same standards, as if the activities were conducted by the lead insured depository institution of the holding company. If the Federal Reserve fails to examine or take an enforcement action against the non-depository subsidiary when recommended by the Federal banking regulator of the holding company's lead insured depository institution, such regulator may itself examine or take enforcement action, as the case may be, against the non-depository subsidiary of the holding company.

Under Title VI of the Act, the Federal Reserve is expressly permitted to issue orders and regulations relating to the capital requirements of bank and thrift holding companies. This authority dovetails with similar authority granted under Title I for nonbank financial companies supervised by the Federal Reserve and large, interconnected bank holding companies. The Federal Reserve's capital rules are to be countercyclical, so that the amount of capital to be maintained by a holding company increases during an economic expansion and decreases during economic contraction. The other Federal banking agencies are required to make their capital standards for insured depository institutions countercyclical as well.

Another important expansion of Federal Reserve authority in Title VI is that the Federal Reserve is obligated to require bank and thrift holding companies to act as the source of financial strength for any subsidiary depository institution. If the parent of an insured depository institution is not a bank or thrift holding company, then the appropriate Federal banking agency for the insured depository institution must require the parent to serve as a source of strength for the institution.

3. Powers, Mergers & Acquisitions, Conversions

In an expansion of the well-capitalized and well-managed rules applicable to depository institutions, the Act requires that a bank holding company that is a financial holding company and able to engage in expanded financial activities authorized by the Gramm-Leach-Bliley Act be and remain well-capitalized and well-managed. Similarly, a savings and loan holding company (other than grandfathered unitary savings and loan holding companies) wishing to engage in these expanded financial activities must meet the same well-capitalized and well-managed standards (and other requirements) as a bank holding company. The savings and loan holding company would then be required to conduct the expanded activities in compliance with the Bank Holding Company Act.

The Bank Holding Company Act is further amended by the Act to require a financial holding company to receive Federal Reserve approval before acquiring a nonbank company engaged in permissible financial activities with more than $10 billion in total consolidated assets, absent another operative provision of the Bank Holding Company Act. To complement its authorities granted in Title I, the Federal Reserve must consider the risks to the stability of the US banking or financial system before approving a proposed acquisition, merger, or consolidation.

In addition to the Volcker Rule's concentration limits, the Act imposes limits on interstate merger transactions if the resulting insured depository institution would control more than 10 percent of the total deposits in insured depository institutions in the US. Bank holding companies are also prohibited from such transactions if the holding company and insured depository institution are not based in the same state and the holding company (including insured depository institution affiliates) controls or would control more than 10 percent of total deposits of insured depository institutions in the US. Similar restrictions apply to thrift holding companies. Exceptions are provided for troubled institutions. Moreover, the standards have increased for interstate bank acquisitions and bank mergers: a bank holding company must be well-capitalized and well-managed to acquire shares of a bank located outside the bank holding company's home state; and a surviving bank in an interstate merger transaction must be well-capitalized and well-managed.

The Act generally prohibits banks subject to formal action with respect to a significant supervisory matter from converting from national banks to state-chartered banks or thrifts, and vice versa. Conversion may be available if the proposed regulator is informed of the formal action undertaken by the current regulator and establishes a plan to ensure sound operation of the institution, and the current regulator does not

oppose the proposal. The remedial plan must subsequently be implemented. With respect to branching authorities, national banks and state insured banks are permitted to engage in *de novo* branching if the law of the affected state would permit *de novo* branching for in-state banks.

Title VI also amends HOLA and the Federal Reserve Act to allow insured depository institutions to pay interest on demand accounts, effective one year after enactment. It also amends the definition of "bank" in the Bank Holding Company Act so that credit card banks may make loans to certain small businesses.

4. Transactions with Affiliates and Insiders and Lending Limits

The Act expands the scope of the restrictions on banks' loans to, purchases of assets from, and other "covered transactions" with, affiliates under Section 23A of the Federal Reserve Act in a number of ways. First, it extends the definition of "affiliate" to include any investment fund as to which the bank or an affiliate is an investment adviser. It also broadens the types of "covered transactions" to include any transaction that involves the borrowing or lending of securities where the bank has a credit exposure to the affiliate; the purchase of assets subject to a repurchase agreement; and the acceptance of "other debt obligations" of an affiliate as collateral for a loan to a third party; and any derivative transaction where the bank has a credit exposure to the affiliate. With respect to a bank's collateral obligations under Section 23A, Title VI specifies that the purchase of assets subject to a repurchase agreement constitutes an extension of credit and must, like all extensions of credit and guarantees, be collateralized so long as it is outstanding. As well, the Act requires that securities borrowing and lending and derivatives transactions be collateralized at the levels required under Section 23A at all times and may not be collateralized by low-quality assets or the debt obligations of an affiliate.

As with other provisions in Title VI, the Federal Reserve is granted additional authority with respect to Section 23A. Specifically, it may issue regulations or interpretations that take into account netting agreements between a bank and its affiliate in determining the amount of a covered transaction and whether a covered transaction is fully secured. In addition, the higher transaction allowance in Section 23A with respect to financial subsidiaries of a bank is eliminated.

The Act also modifies the current process by which exemptions for transactions or relationships from Section 23A may be granted. Under the Act, the Federal Reserve may continue to grant exemptions from Sections 23A's requirements by order, but now must also notify the FDIC that the exemption is in the public interest and consistent with the purpose of Section 23A. The FDIC has 60 days to object to the proposed exemption based on a determination that it poses an unacceptable risk to the Federal Deposit Insurance Fund. Similarly, the OCC may grant, by order, exemptions to national banks, with similar notice to the FDIC and subject to the FDIC's objection. There are similar rules for when the FDIC is the applicable federal regulator, subject to the Federal Reserve's objection. The Act likewise amends Section 23B to provide for a similar process for the granting of exemptions and exclusions. Finally, the Home Owners' Loan Act is amended to permit the OCC to grant exemptions to Federal thrifts under the same conditions as noted above.

The rules on bank lending to insiders and their related interests (Regulation O transactions) are also amended by Title VI, by extending the lending limits to derivative transactions, repurchase agreements, reverse repurchase agreements, and securities borrowing and lending transactions between the bank and the person. Under the Act, insured depository institutions are prohibited from purchasing or selling assets to insiders unless the transaction is on market terms. If a purchase or sale exceeds 10 percent of capital and surplus of the insured depository institution, the transaction must also be approved in advance by a majority of disinterested members of the board of directors.

Finally, similar to the expansion of the definition of "covered transactions" for purpose of the transactions with affiliates rules, the Act expands the calculation of a national bank's total outstanding loans and credits under the national bank lending limits to include credit exposure from derivative transactions, repurchase agreements, reverse repurchase agreements, and securities lending or borrowing transactions. State chartered banks may only be able to engage in derivative transactions if the law

governing lending limits in a bank's home state takes into consideration credit exposure to derivative transactions. This provision will be effective two-and-a-half years after enactment (18 months from the date of the elimination of the OTS).

5. Amendments to the Home Owners' Loan Act

Title VI contains numerous amendments to HOLA. As a parallel to the intermediate holding company provisions of Title I, the Federal Reserve is authorized to require grandfathered unitary savings and loan holding companies engaging in non-financial activities to establish an intermediate holding company (which would also be a savings and loan holding company) to conduct all or a portion of the holding company's financial activities. In fact, the Federal Reserve must require the establishment of an intermediate holding company if the Federal Reserve determines that it is necessary to appropriately supervise the company's financial activities and prevent supervision of its non-financial activities. The grandfathered unitary savings and loan holding company would no longer be a savings and loan holding company solely because it controls the intermediate holding company, but it would still be required to serve as a source of strength for the intermediate holding company and subject to examination and report requirements. Under certain circumstances, grandfathered unitary savings and loan companies may continue to engage in internal financial activities without the use of an intermediate holding company, subject to review by the Federal Reserve of potential risk to the grandfathered unitary savings and loan company or financial stability. The Act authorizes the Federal Reserve to promulgate regulations establishing criteria for determining when a grandfathered unitary savings and loan holding company should be required to establish an intermediate holding company and establishing restrictions or limitations on transactions between the intermediate holding company and its affiliates.

The Act also modifies the impact of a thrift's failure to become or remain a qualified thrift lender under HOLA. Non-qualified thrift lenders would be subject to activity and branching restrictions applicable to national banks. Restrictions on dividends would also be imposed unless the dividend would be permissible for a national bank, necessary to meet the obligations of the parent holding company, and approved by the OCC and Federal Reserve by prior written request. Title VI further amends HOLA to exempt companies from the definition of savings and loan holding company that: (1) are, or are directly or indirectly controlled by, a bank holding company; (2) control a savings association functioning solely in a trust or fiduciary capacity as described under Section 2 of the Bank Holding Company Act; or (3) as noted above, are grandfathered unitary savings and loan holding companies with intermediate holding companies.

Subsidiaries of mutual holding companies that are savings associations must give notice of dividend payments to the appropriate federal banking regulator and the Federal Reserve at least 30 days in advance. If notice is not properly given, the dividend will be invalid. Under certain circumstances, a mutual holding company may waive the right to receive dividends declared by a subsidiary.

6. Volcker Rule: Proprietary Trading and Related Provisions

Title VI establishes a modified version of the Volcker Rule, a key component of the Act's financial reform goals, which generally prohibits "banking entities" from engaging in "proprietary trading" or investing in or owning hedge or private equity funds. The Rule also imposes concentration limits and limits on conflicts of interest in ABS transactions. The original Volcker Rule aimed to ban commercial banks from such proprietary trading, to prohibit them from sponsoring hedge funds or private equity funds, and to impose concentration limits on financial company mergers, consolidations, and acquisitions. Title VI enacts the general principle of this rule, but it provides several exceptions to these prohibitions and grants regulators substantial authority to define further the extent of the Rule.

The Volcker Rule states that unless an exception applies, a "banking entity" (an insured bank or thrift, a company that controls an insured bank or thrift, a company that is treated as a bank holding company under Section 8 of the International Banking Act of 1978, and any affiliate of these entities) may not engage in proprietary trading or acquire or retain any ownership interest in or sponsor a hedge fund or a

private equity fund. Further, nonbank financial companies supervised by the Federal Reserve that engage in proprietary trading or hedge or private equity fund ownership or sponsorship are, with certain exceptions, subject to additional capital and quantitative limits with respect to such activities, though those activities are not generally banned. Proprietary trading by a banking entity is defined as generally engaging as the principal for the "trading account" (as defined by the Rule) of the banking entity or nonbank financial company supervised by the Federal Reserve in securities, derivatives, options, or commodities transactions.

The Volcker Rule contains several complex exceptions to the proprietary trading ban described above. The ban on proprietary trading does not apply to the trading of US Government or agency obligations, or of other obligations, including Fannie Mae, Freddie Mac, Ginnie Mac, and state and municipal obligations and certain other US Government entity obligations, including those of the Federal Home Loan Banks. The ban also does not apply to market-making, risk-mitigating hedging, trading on behalf of customers, investments in certain small business investment corporations, and certain insurance activities.

The Volcker Rule also provides exceptions to its general ban on hedge and private equity involvement or sponsorship. Organizing, offering, or sponsoring a private equity or hedge fund, foreign trading, or acquisition of an interest in foreign hedge or private equity funds are permitted if numerous conditions are all met. Among these conditions are that the banking entity must provide bona fide trust, fiduciary, or investment advisory services, the fund must be organized and offered only in connection with those services, and the banking entity cannot share a name with the fund or have an ownership interest in the fund apart from limited circumstances. Even with these exceptions, the Rule restricts certain conflicts of interest and bars use of a banking entity's name or a variation thereof with a fund. A banking entity may not acquire or retain an equity, partnership, or other ownership interest in a fund aside from limited seed and *de minimis* investments. Within a year of a fund's establishment, the banking entity's investment must fall below three percent of the total ownership of the fund, and at all times the banking entity must not exceed the limit of three percent of Tier 1 capital for investments in funds.

However, there are a series of limitations on the above permitted activities. Under no circumstance may a banking entity have a material conflict of interest between the banking entity and its clients, customers, or counterparties. Nor may banking entities engage in activities with material exposure to high risk assets or high risk trading strategies (to be defined by regulation). Further, banking entities are barred from engaging in activities that pose a threat to the banking entity's safety and soundness or to US financial stability. In addition, the SEC and CFTC, together with the federal banking agencies, are required to impose capital requirements and quantitative limits on the exceptions described above to protect the safety and soundness of the banking entity and US financial stability.

The Volcker Rule also restricts banking entities or their affiliates from conducting certain transactions with hedge funds or private equity funds. In general, no banking entity or affiliate that organizes or serves as the investment manager, investment adviser, or sponsor to a hedge fund or private equity fund may enter into a covered transaction, as defined by Section 23A of the Federal Reserve Act, with either the fund or other funds controlled by the fund. Also, a banking entity (but not including its affiliates) that serves as the investment manager or adviser to a hedge fund, or that organizes or offers the fund, is subject to restrictions in Section 23B of the Federal Reserve Act. (*See* Title VI, subsection 4 above.) These restrictions are subject to certain exceptions, including one permitting the Federal Reserve to allow banking entities or nonbank financial companies supervised by the Federal Reserve under certain conditions to enter prime brokerage transactions with hedge funds or private investment funds, even if other funds with certain relationships to the entity have an interest in the fund involved in the prime brokerage transaction. Though nonbank financial companies supervised by the Federal Reserve are not subject these restrictions, the SEC, CFTC, and appropriate federal banking agencies must impose on such companies additional capital charges and other requirements to address the risks to banking entities addressed by these restrictions.

Title VI provides that the proprietary trading and fund-related provisions of the Volcker Rule apply even if another law explicitly authorizes a banking entity or covered nonbank financial company supervised by the Federal Reserve to engage in that activity. This preemption provision does not apply to laws governing a banking entity's or systemic nonbank financial company's ability to sell or securitize loans.

The Act authorizes several studies relating to the Volcker Rule. Most notably, within six months of enactment, the Council shall study and make recommendations on implementing the Rule to fulfill various financial stability and safety and soundness goals. Within nine months of this study's completion the Federal Reserve, the appropriate federal banking agencies, the SEC, and the CFTC, must consider the study's findings and issue regulations to implement the Rule. The Secretary of the Treasury is responsible for coordinating rulemaking among these agencies. The Act also requires two studies in connection with proprietary trading. The Council must study and make recommendations on implementing the provisions of the Volcker Rule within six months of enactment, and Title IX of the Act requires a GAO study (and a report to Congress within 15 months of enactment of the Act) on proprietary trading, defined there more broadly than in the Volcker Rule. Finally, within 18 months of the Act's enactment, the appropriate federal banking agencies must jointly prepare a report on the activities that a banking entity may engage in under federal and state law and provide recommendations regarding the activities' appropriateness and potential negative effects on safety and soundness and the US financial system.

The above portions of the Volcker Rule will be phased in. None of its provisions will become effective until the earlier of 12 months after the issuance of related rules or two years after enactment. Liquid funds are eligible for a two-year transition period with up to three one year extensions, for a possible maximum of five years. Illiquid funds are eligible for a two-year transition with the possibility of a single up-to-five-year extension beyond the extension(s) for liquid funds, for a possible maximum of 10 years.[7]

Title VI also contains several other restrictions addressed by or related to the original Volcker Rule. The title imposes concentration limits on financial company mergers, consolidations, and acquisitions. Generally, the Rule bars consolidations resulting in consolidated liabilities exceeding 10 percent of the aggregate consolidated liabilities of all US financial companies. Bank holding companies also are prohibited from such transactions if the holding company and insured depository institution are not based in the same state and the holding company controls or would control more than 10 percent of total deposits of insured depository institutions in the US Similar restrictions apply to thrift holding companies. The concentration limits do not apply if the target bank is in default, if the FDIC provides assistance to the transaction because the target bank is in troubled condition, or if the acquisition would only result in a *de minimis* increase in the financial company's liabilities. Within six months of enactment, the Council must complete a study addressing how these concentration limits would affect financial stability and the competitiveness of US financial firms and markets and make recommendations for modifications to these limits. The Federal Reserve must issue final regulations implementing these limits and reflecting the Council's study no later than nine months after the study's completion.

Finally, Title VI limits conflicts of interest in ABS transactions. An underwriter, placement agent, initial purchaser, sponsor, or an affiliate or subsidiary of such entity, of an asset-backed security (including a synthetic ABS) may not participate in a transaction that would lead to a material conflict of interest with respect to any investor in a transaction arising out of such activity. Exceptions are provided for mitigating hedging activities designed to reduce risks associated with positions or holdings arising out of the

[7] The effective dates and timelines in the Act are numerous and confusing. As noted earlier, Section 4 of the Act provides that except as otherwise specifically provided, "this Act and such amendments shall take effect 1 day after the date of enactment." The effective date for Section 619, except for the divestiture provisions for liquid and illiquid funds, is the earlier of two years after enactment of this section or 12 months after the date of issuance of final rules except as otherwise provided (as, for example, for the calculation of the divestiture period). This leaves the starting date for the calculation in some doubt. Does it begin immediately, or in two years? While not free from doubt, we read the divestiture calculation to begin from the effective date of the entire Dodd-Frank Act, rather than of Section 619. If the other interpretation were to be adopted, two additional years would be available to divest liquid (7 years) and illiquid (12 years) funds.

underwriting, placement, initial purchase, or sponsorship of the given ABS, and for certain ABS purchases and sales for liquidity or market-making purposes. The SEC must promulgate implementing regulations within 270 days of enactment of the Act, and the conflict of interest restrictions become effective when the SEC's final rules take effect.

7. Securities Holding Companies

The Act establishes a new framework for securities holding companies, eliminating the current investment bank holding company construct in the Securities Exchange Act of 1934 ("Exchange Act"). Under the Act, a securities holding company is, generally, an entity that owns or controls one or more brokers or dealers registered with the SEC but which is not otherwise supervised by, or the parent or affiliate of an entity supervised by, a US banking regulator or subject to comprehensive consolidated supervision by a foreign regulator. A securities holding company that is required by a foreign regulator or foreign law to be subject to comprehensive consolidated supervision may register with the Federal Reserve and be subject to its supervision and regulation, including capital adequacy, risk management, examination, recordkeeping, and reporting requirements.

G. Title VII: The Wall Street Accountability and Transparency Act of 2010 (OTC Derivatives)

Title VII of the Act, the "Derivatives Title," effects a sweeping overhaul of the OTC derivatives markets. It requires that virtually all swaps and security-based swaps, defined broadly to capture the vast number of derivative instruments currently traded OTC, be centrally cleared and traded on exchanges or alternative execution facilities. It also requires registration of and imposes comprehensive regulation on virtually all significant market participants. It splits jurisdiction over swaps between the CFTC and the SEC, but also requires the federal banking regulators to set prudential requirements for entities they primarily regulate. In numerous instances, the Derivatives Title requires joint rulemaking and/or coordination by the various regulators. Like other sections of the Act, it is enormously complex and most of the details will need to be resolved through the rulemaking and exemptive processes. Below is a summary of the Derivatives Title, with expanded discussion of some of the more relevant or controversial provisions.

1. Swaps and Security-based Swaps: Definitions and Jurisdiction

The Derivatives Title generally gives the CFTC jurisdiction over swaps (under Subtitle A of the Derivatives Title) and the SEC jurisdiction over security-based swaps (under Subtitle B). Both agencies are required to "consult and coordinate" with each other and with the relevant prudential regulators to assure consistent and comparable regulation. If either the CFTC or the SEC objects to a final rule of the other agency, it may petition the US Court of Appeals for the DC Circuit to set aside the rule. Joint rulemaking by the CFTC and the SEC, in consultation with the Federal Reserve and with consideration of the views of the federal banking regulators, is required in a number of cases. If the agencies fail to prescribe joint rules as required under the Act, the Council is empowered to resolve the dispute. Any interpretation or guidance issued by the agencies in connection with joint rulemaking must be jointly issued.[8]

The CFTC has exclusive authority to enforce the provisions relating to swaps, while the SEC has primary authority to enforce provisions relating to security-based swaps, except that federal bank regulators have enforcement authority with respect to swap dealers and major swap participants that they regulate. The federal bank regulators can refer suspected violations of non-prudential provisions or rules to the CFTC or SEC, as appropriate. Similarly, the CFTC and SEC can refer suspected violations of prudential provisions to the appropriate federal bank regulator. Each of the regulators has backstop authority if the primary regulator does not initiate an enforcement proceeding within 90 days of the referral. The Act defines the term "swap" broadly to capture any product known today as a swap and virtually any other derivative instrument, including without limitation an interest rate swap, a rate floor, rate cap, rate collar,

[8] This memorandum uses the term "swap" to refer both to swaps and security-based swaps except as specifically noted. Thus, for example, the terms "swap dealer" and "major swap participant" will include security-based swap dealers and major security-based swap participants as well.

cross-currency rate swap, basis swap, currency swap, foreign exchange swap, total return swap, equity index swap, equity swap, debt indexed swap, debt swap, credit spread, credit default swap, credit swap, weather swap, energy swap, metal swap, agricultural swap, emission swap, or commodity swap, and any instrument that is commonly known to the trade as a swap. It also includes a security-based swap agreement that meets the definition of "swap agreement" in the Gramm-Leach-Bliley Act and is based on the price, yield, value, or volatility of any security or any group or index of securities.[9]

Although foreign exchange swaps and forwards are currently included in the definition of "swap," the Secretary of the Treasury may determine at any time, subject to a number of required considerations, that either or both should not be regulated as swaps. If cleared and traded on an exchange or swap-execution facility, these swaps and forwards will not be exempt from prohibitions on fraud and manipulation.

The definition of swap also excludes most security-based swaps. A security-based swap is defined as an instrument that would be a swap and is based on: (1) a narrow-based security index; (2) a single security or loan; or (3) the occurrence, nonoccurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, if the event directly affects the financial statements, financial condition, or financial obligations of the issuer. The addition of instruments based on loans is a significant new development.

The Act repeals Section 206B of the Gramm-Leach-Bliley Act and makes explicit that security-based swaps are securities subject to the Securities Act of 1933 ("Securities Act") and the Exchange Act. The Act does not exempt security-based swaps from registration under Section 5 of the Securities Act, although the House Bill would not have required registration.

Under the Act, the CFTC and SEC, in consultation with the Federal Reserve, are required to adopt a joint rule further defining "swap" and "security-based swap" within 360 days of enactment. This rulemaking will need to clarify a number of questions regarding whether an instrument should be characterized as a swap.

The CFTC and SEC have no jurisdiction over an "identified banking product," as defined in Section 206 of the Gramm-Leach-Bliley Act, unless a federal bank regulator excepts the product from exclusion, which it may do if it determines (in consultation with the CFTC and SEC) that the product would meet the definition of swap or security-based swap and that the product has either become known as a swap or security-based swap or has been structured as an identified banking product to evade federal securities or commodities laws.

As discussed more fully below, all swaps accepted for clearing and required by the regulators to be cleared must be cleared through a DCO, unless an exception or exclusion applies. Any swap required to be cleared must also be executed on a designated contract market, an exchange, or a swap execution facility (collectively an "exchange") if any such facility makes the swap available to trade. In addition to requiring registration of clearing, trading, and reporting infrastructure entities, the Derivatives Title also creates and requires regulation of two new categories of swap participants: swap (or security-based swap) dealers and major swap (or security-based swap) participants. Swap dealers and major swap participants will be subject to a myriad of new regulations, including registration with the CFTC and/or SEC, as appropriate, recordkeeping and reporting requirements, capital and margin requirements, and business conduct requirements. Swap dealers and major swap participants will not be exempted from the clearing or exchange-trading requirements.

2. Swap Dealers and Major Swap Participants

The Act adds new Section 4s to the Commodity Exchange Act and new Section 15F to the Exchange Act, which cover registration and regulation of swap/security-based swap dealers and major swap/security-

[9] The CFTC and SEC are required to conduct a joint study to determine whether stable value contracts fall within the definition of a swap. If they determine that stable value contracts are swaps, they must jointly determine whether an exemption from the definition is appropriate.

based swap participants respectively. The Act generally does not distinguish between swap dealers and major swap participants and subjects both to sweeping new regulation.[10] Both swap dealers and major swap participants are broadly defined to include virtually any significant derivatives market actor. Every swap dealer and major swap participant must register as such with the appropriate regulator under rules required to be promulgated within one year of enactment of the Act. Dual registration is required for swap dealers and major swap participants engaging in both swap and security-based swap transactions. Moreover, although the Act treats swap dealers and major swap participants largely the same, it allows the CFTC and SEC to adopt appropriate rules for such entities, as discussed further below, theoretically allowing for different treatment, consistent with the requirements of the Act.

A swap dealer is defined as any person who: (1) holds itself out as a swap dealer; (2) makes a market in swaps; (3) regularly enters into swaps as an ordinary course of business for its own account; or (4) engages in activity that causes it to be commonly known in the trade as a dealer or market maker. The definition specifically excludes an insured depository institution that offers or enters into a swap with a customer in connection with a loan to that customer, and also contains an exclusion for a person trading swaps for its own account, either individually or as a fiduciary, but not as a part of a regular business. Notably, Congress adopted a House provision that also provides an exception for entities that engage in *de minimis* swap dealing in connection with transactions with or on behalf of their customers.

A major swap participant is defined as any non-swap dealer that: (1) maintains a substantial position in swaps, except positions held for hedging or mitigating commercial risk;[11] (2) whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the US banking system or financial markets; *and/or* (3) is a financial entity that is highly leveraged relative to the amount of capital it holds, is not subject to a federal banking agency's capital requirements, and maintains a substantial position in outstanding swaps. With respect to CFTC-regulated swaps, the definition specifically excludes captive financing arms, *i.e.*, entities whose primary business is providing financing and that use swaps to hedge underlying commercial risks related to interest rate and foreign currency exposures, at least 90 percent of which arise from financing the purchase or lease of products, at least 90 percent of which are manufactured by an affiliate.

The regulators are required to define "substantial position," taking into consideration an entity's relative position in uncleared versus cleared swaps and possibly the value and quality of collateral held against counterparty exposures. They are also required to define "swap dealer" and "major swap participant" further, as well as to define "commercial risk." A significant question that may be settled at least partially through rulemaking is what constitutes a hedge or mitigation of commercial risk. The CFTC and SEC are also required to adopt other joint uniform rules relating to dealers and major swap participants, such as business conduct, reporting, and recordkeeping rules.

Swap dealers and major swap participants will be subject to strict reporting and recordkeeping requirements pursuant to rules promulgated jointly by the CFTC and SEC within a year of the effective date of the Act. They will also be subject to new rules regarding back office policies and procedures, including with respect to timely and accurate confirmation, processing, netting, documentation, and valuation of all swaps. They will be required to implement internal controls to monitor trading to prevent violations of position limits and to establish information barriers between research and analysis on the one hand and trading or clearing on the other.

All swap dealers and major swap participants will be required to meet minimum margin requirements for all uncleared swaps. Capital standards are required for all swap dealers and major swap participants regardless of whether a swap is cleared. The federal banking regulators will set the capital and margin standards for bank swap dealers and major swap participants, while the CFTC and SEC will jointly

[10] A notable exception, discussed below, is Section 716 of the Act, the swap Push-Out Rule.
[11] Positions held by an ERISA employee benefit plan that are held primarily for hedging are also excluded.

prescribe such standards for nonbank swap dealers and major swap participants. Consultation is required to ensure both consistency and that the standards for uncleared swaps address the safety and soundness of the swap dealer or major swap participant and are also appropriate for the risks associated with such swaps.

The Act provides that initial and variation margin are required for all swaps not cleared by a registered DCO, including swaps that the regulators determine must be cleared but that are not accepted for clearing by any DCO. The clearing requirement is discussed more fully below. The Act does not explicitly exclude from margin requirements persons or swaps that are exempted from the clearing requirement, however, leaving open critical questions for market participants. Senators Christopher Dodd and Blanche Lincoln have attempted to address these questions in a June 30 letter. The letter makes clear the authors' intent that end users should not be subject to any margin requirements. It also tries to reaffirm the intent that there be "legal certainty" surrounding existing swaps, as provided in Section 739. Neither Section 739 nor the letter, however, explicitly addresses whether margin can be imposed on existing swaps.[12]

New business conduct rules, including rules addressing fraud, manipulation and abuse, supervision, and adherence to position limits, will be established for swap dealers and major swap participants. The Derivatives Title also requires establishment of new duties relating to verification that a counterparty is an eligible contract participant and to disclosures about risks, fees, incentives, and conflicts. Very significantly, it also imposes duties on swap dealers and major swap participants when advising or acting as counterparty to a "special entity," which is defined to include, among other things, a federal agency, a state or political subdivision, an ERISA employee benefit or governmental plan, or any endowment.

When offering or entering into such a swap, the swap dealer or major swap participant must have a "reasonable basis" to believe that the special entity has an independent representative advising it and that the representative meets certain enumerated standards, including that it has sufficient knowledge to evaluate the transaction and the risks and that it "undertakes a duty to act in the best interests of the counterparty it represents." When a swap dealer or major swap participant acts as an adviser to a special entity, it will have a fiduciary duty to that entity. These duties are inapplicable when a transaction is initiated by the special entity on an exchange and the swap dealer or major swap participant does not know the identity of the counterparty.

With some exceptions, associated persons subject to statutory disqualification are prohibited from engaging in derivative activities on behalf of the swap dealer or major swap participant. The SEC also can reject the application or limit the activities of a swap dealer or major swap participant if (among other things) "any person associated with" such swap dealer or swap participant has certain disciplinary history.

3. Swap Push-Out Rule

One of the most contentious provisions in the earlier Senate Bill was the "Lincoln Amendment," which essentially would have forced all entities with access to FDIC insurance or to the Federal Reserve discount window to divest themselves of or "push out" their swaps operations. The final Push-out Rule, in Section 716 of the Act, is significantly narrower than the original version. It prohibits the provision of any "Federal assistance" to a "swaps entity" with respect to any swap or swap activity of the swaps entity. Federal assistance includes any advances from a Federal Reserve credit facility or discount window that does not have broad-based eligibility standards as well as any FDIC insurance or guarantee.

[12] In the letter, addressed to Conference Chairman Frank and Representative Peterson, the Senators state that: "Congress recognized that the capital and margin requirements in this bill could have an impact on swaps contracts currently in existence," and that Congress "provided legal certainty to those contracts currently in existence, providing that no contract could be terminated, renegotiated, modified, amended or supplemented ... based on the implementation of any requirement in this act." The letter also states unequivocally that end users should not be subject to margin requirements and it instructs that the regulators "must carefully follow Congressional intent" in implementing the provisions of the Act and that they may not make rules "in a way that requires the imposition of margin requirements on the end user side of a lawful transaction." The letter is available at http://www.wilmerhale.com/files/upload/June 30 2010 Dodd_Lincoln_Letter.pdf.

Swaps entities are defined as swap dealers and major swap participants registered under the provisions of the Act. However, the compromise provision excludes from the definition any major swap participant that is an insured depository institution. Also excluded are insured depository institutions and "covered financial companies" under Title II of the Act that are in a conservatorship, receivership, or are bridge banks operated by the FDIC. The definition of swaps entity does not explicitly exclude swap dealers that are insured depository institutions, but such swap dealers are now permitted to benefit from federal assistance if they limit their swap activities to hedging and other similar risk mitigating activities directly related to the insured depository institution's activities, or to swap transactions involving rates or reference assets permissible for investment by a national bank, other than credit default swaps unless such CDS are cleared by a DCO. All other swap activities, such as uncleared CDS, commodities, metals (except gold and silver), energies, and equities, may be conducted by nonbank affiliates of bank or savings and loan holding companies that are supervised by the Federal Reserve and that comply with the limitations on affiliate transactions under Sections 23A and 23B of the Federal Reserve Act.

Notwithstanding the explicit exclusions in Section 716, the Council has the discretion, upon a two-thirds determination which must include the Secretary of the Treasury, and the Chairs of the Federal Reserve and the FDIC, to prohibit federal assistance to swaps entities if necessary to mitigate systemic risk and protect taxpayers. Moreover, neither a bank nor a bank holding company will be permitted to be or become a swaps entity unless it complies with minimum prudential standards to protect its safety and soundness and to mitigate systemic risk.

Swaps entered into before the "end of the transition period" will be grandfathered and not subject to the prohibition of Section 716. The transition period for divestiture or cessation of swap activities will begin two years after the effective date of the Act (one day after enactment) and will last for up to 24 months (as determined by the appropriate federal banking regulator, consulting with the CFTC and/or the SEC). It may then be extended for up to an additional year. Thus, swap dealers that have access to federal assistance will essentially have up to five years to carve out their derivatives activities.[13]

Section 716 explicitly extends the Volcker Rule prohibitions on proprietary trading under Section 619 of the Act to the derivatives operations of insured depository institutions. (*See* the discussion of the Volcker Rule under Section VI.)

4. Clearing Requirements and Derivatives Clearing Organizations

Generally, all standardized derivatives accepted by a registered or exempt DCO and required to be cleared by the CFTC and/or the SEC must be cleared. The rules of a DCO must provide for non-discriminatory access. DCOs will be required to designate a compliance officer with attendant responsibilities as well as to follow conflict of interest rules and/or financial safeguard requirements, including among other things, margin requirements and the ability to cover their operating costs, as well as any other rules that the CFTC and SEC prescribe. Notably, the Act specifies that under no circumstances will a DCO be compelled to accept the counterparty credit risk of another DCO. DCOs will be subject to reporting, recordkeeping and inspection requirements. They will also be required to provide market participants with enough information to identify and evaluate risks and costs, and to disclose publicly their rules and operating procedures, margin-setting methodology, information about their

[13] As noted earlier in this memorandum, the effective dates in the Act are not completely clear. While Section 4 provides that except as otherwise specifically provided, "this Act and such amendments shall take effect 1 day after the date of enactment," the effective date for the two subtitles of the Derivatives Title is 360 days after enactment of the subtitles unless otherwise provided (Sections 754 and 774). Section 716 provides that the federal assistance prohibition "shall be effective 2 years following the date on which this Act is effective" (emphasis added). There could be a question whether "this Act" refers to the entire Dodd-Frank Act, or just the Derivatives Title, which is subtitled, "The Wall Street Transparency and Accountability Act of 2010." While not free from doubt, we read Section 716 to mean one day after the enactment of the entire Dodd-Frank Act. We thus interpret the provision to mean that the two year transition period will begin the day after enactment of the entire Dodd-Frank Act and not 360 days thereafter.

financial resources, the terms and conditions of cleared and settled contracts, fees charged, and aggregate daily settlement prices, volume, and open interest for all settled and cleared contracts.[14]

DCOs must submit to the CFTC or SEC for review any category of swaps that they plan to accept for clearing. The CFTC and SEC must also periodically review categories of swaps on their own to determine whether they must be cleared. In making their determination, the regulators must consider a number of factors, including: (1) the existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data; (2) the availability of resources and infrastructure; (3) the effect on the mitigation of systemic risk considering the market for the swap and the resources of the DCO; (4) the effect on competition; and (5) the existence of legal certainty if the DCO becomes insolvent. The regulators may stay the clearing requirement while they complete their review and they may also impose additional terms and conditions on a clearing requirement. The CFTC and SEC must also prescribe additional rules to prevent evasion of the clearing requirement.

The House Bill had exempted from mandatory clearing swap transactions in which one of the counterparties was neither a swap dealer nor a major swap participant. The final exemption in the Act is narrower, however, and now excepts from clearing any entity that: (1) is not a financial entity; (2) is using swaps to hedge or mitigate commercial risk; *and* (3) notifies the CFTC or SEC how it generally meets its financial obligation associated with entering into non-cleared swaps.

A financial entity is defined as a swap dealer, a major swap participant, a commodity pool, an employee benefit plan, a private fund, or a person predominantly engaged in activities that are in the business of banking or financial in nature under Section 4(k) of the Bank Holding Company Act. For swaps, but not security-based swaps, as with the definition of major swap participant, this definition excludes a captive financing arm that primarily provides financing for the purchase or lease of a parent's or subsidiary's merchandise or goods. The CFTC and SEC may also exclude from the financial entity definition (and thus from the clearing requirement) banks, savings associations, farm credit systems, and credit unions with assets of $10 billion or less. Note that an entity that is not a swap dealer and whose non-hedged position is not substantial enough to be deemed a major swap participant would not be able to rely on the end user exception if it is a "financial entity."

An affiliate may claim its parent or subsidiary's exemption as long as the affiliate is not a swap dealer, major swap participant, investment company, commodity pool, or bank holding company with over $50 billion in consolidated assets, and as long as it is using the swap to hedge the commercial risk of the end user or other non-financial entity affiliate. If the affiliate is predominantly engaged in providing financing for the purchase or lease of merchandise or manufactured goods of the end user, it may rely on the exemption for no less than a two-year period.

An end user excluded from the clearing requirement may nonetheless elect to clear the swap and to choose the DCO to clear the transaction. Existing swaps are not subject to the clearing requirement, but as discussed below, they are required to be reported.

5. Exchange-Trading Requirements

All swaps subject to mandatory clearing must be traded on an exchange unless no exchange makes the swap available to trade. To protect less sophisticated investors, a "non-eligible contract participant" is only

[14] The Act does not incorporate the "Lynch Amendment" from the House Bill, which would have placed a 20% voting restriction on the ownership of a DCO, exchange, or swap execution facility by swap dealers, major swap participants, or any identified financial holding company associated with either a swap dealer or major swap participant. Instead, the Act generally incorporates the more moderate Senate approach, directing the CFTC and SEC to adopt rules "which may include numerical limits on the control of, or the voting rights with respect to" a DCO, swap execution facility, exchange, or board of trade by a bank holding company, a nonbank financial company, a swap dealer, major swap participant, or associated person of a swap dealer or major swap participant. The Act provides considerations for the CFTC and SEC when determining these rules, including any conflicts of interest that may arise from concentrated ownership and the governance arrangements of the entity.

allowed to enter into a swaps transaction through an exchange. The regulators are given explicit authority to refine the definition of "eligible contract participant."

An "exchange," as used in this memorandum, includes an exchange as defined under Section 3(a) of the Exchange Act, a designated contract market under Section 5 of the Commodity Exchange Act, or a registered or exempt swap execution facility. A swap execution facility is "a facility trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by other participants that are open to multiple participants in the facility or system" and includes facilities that are not designated contract markets but on which swaps are traded. This definition excludes facilities that operate a bilateral platform. The CFTC and SEC may prescribe rules defining the universe of swaps that can be executed on a swap execution facility, with the goal of promoting such trading and also promoting pre-trade price transparency in the swaps market.

Alternative swap execution facilities need to demonstrate that they have adequate resources and rules to deter abuse. They must also comply with a set of "core principles," including that they will permit trading only in swaps "not readily susceptible to manipulation," as well as with any rules established by the CFTC or SEC, as appropriate. CFTC-regulated swap execution facilities will be required to adopt position limits for each contract "as is necessary and appropriate," no higher than the level set by the relevant regulatory agency. Congress removed a similar provision that would have been applicable to security-based swap execution facilities. All swap execution authorities will need to adopt emergency rules that include the authority to limit or suspend trading.

The Act provides that the CFTC may adopt rules requiring registration of foreign boards of trade that provide US participants with direct access to the electronic trading and order matching systems, taking into consideration the degree of home country regulation. Certain existing foreign boards of trade will be grandfathered, if the CFTC adopts registration requirements. Presumably because Congress was concerned about anti-competitive effects on US companies doing business abroad, this provision is weaker than earlier language. Under a separate provision, the CFTC and/or the SEC may, in consultation with the Secretary of the Treasury, prohibit a foreign entity from participating in swap activities if they determine that swaps regulation in the country of residence of the foreign entity "undermines the stability of the [US] financial system."[15]

6. Reporting

All uncleared contracts must be reported to a swap data repository which must register under the Act and be subject to inspection and examination. A data repository is "any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for swaps." Reporting is required as follows:

Existing swaps. Swaps entered into before enactment of the Act must be reported to a data repository or to the CFTC or SEC within 180 days of the effective date of the Derivatives Title (one year after enactment). Swaps entered into after enactment but before application of the clearing requirement must be reported within 90 days (or more) of the effective date of this title.

Other cleared and uncleared swaps. Where only one party is a major swap participant or swap dealer, that entity must report the transaction. Where the transaction is between a swap dealer and a major swap participant, the swap dealer has the reporting obligation. In all other transactions, the counterparties must select the reporting party. Transactions must be reported to the appropriate regulator if a data repository refuses to accept them.

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[15] The Derivatives Title requires the CFTC and SEC to conduct a comprehensive comparative study on swap and clearing agency regulation in the US, Europe, and Asia.

Data repositories must make available on a confidential basis all data, including individual counterparty trade and position data, to the CFTC, the SEC, the federal banking regulators, the Council, the Department of Justice, and, if the primary regulators deem it appropriate, with foreign authorities. The CFTC and SEC must prescribe rules to make real-time data of most swap transactions public in a way that maintains anonymity of traders, specifies the appropriate time for reporting block trades, and considers the effect of disclosure on market liquidity. Additionally, the CFTC and SEC are required to make publicly available, in a way that protects individual information, aggregate data on swap trading volumes and positions. Reporting and recordkeeping requirements for uncleared swaps must be at least as comprehensive as for cleared swaps.

The Act amends Sections 13(d), (f), and (g) of the Exchange Act to provide for a person to become or be deemed a beneficial owner of an equity security for purposes of Sections 13(d) and 16 of the Exchange Act "upon the purchase or sale of a security-based swap." The SEC must determine, after consulting the Secretary of the Treasury and the federal banking regulators, that the purchase or sale of a security-based swap or class of security-based swaps "provides incidents of ownership comparable to direct ownership of the equity security," and that it is necessary to deem the transaction to be the acquisition of a beneficial ownership of the equity security "to achieve the purposes of this section."

7. Position Limits

The CFTC and SEC are authorized to adopt aggregate position limits (including related hedge exemption provisions) under the Act. The CFTC also is required to conduct a study and report to Congress within a year of imposing position limits on their effects (if any) on excessive speculation and on the migration of transactions outside the US.

With respect to position limits set by the CFTC, the version passed by the House provides more guidance than had previous versions. Specifically, it directs the CFTC to strive to ensure that any limits imposed will not cause price discovery in the commodity to shift to foreign boards of trade. Limits are to be set on the number of positions that may be held by any person for the spot month, for every other month, and on the aggregate number of positions that may be held by any person for all months. The CFTC is given discretion to set limits that address speculation, deter and prevent market manipulation, ensure sufficient liquidity for "bona fide hedges," and ensure that the price discovery function of the underlying market is not disrupted. For purposes of position limits, a "bona fide hedge" is a transaction or position that: (1) represents a substitute for transactions to be made at a later time in a physical channel, is economically appropriate to the reduction of risks in the management of a commercial enterprise, and arises from the potential change in value of assets, liabilities, or services; or (2) reduces risk attendant to a position that was executed opposite a counterparty who met the definition above. The extent to which this definition may inform the regulators' approach to hedging in other sections remains to be seen.

With respect to security-based swap positions, the SEC is permitted to exempt any person, security-based swap or transaction from the position limits. It is also permitted to direct any self-regulatory organization to adopt rules regarding position size, not only for member firms, but for "any person for whom a member of such SRO effects transactions in such security-based swap or other security." This provision could result in a substantial competitive disadvantage for US broker-dealers.

The CFTC and SEC are also authorized to adopt rules relating to large trader reporting. Notably, the Act provides that in determining whether any position exceeds the position limits set by the regulators, the positions whether "directly or indirectly" entered into must be included. There appears to be no room for Regulation 13D type disaggregation procedures for calculating these limits, although those procedures continue to apply in other contexts/markets.

H. Title VIII: The Payment, Clearing and Settlement Supervision Act of 2010

Title VIII of the Act focuses on the importance to the financial system of clearing and settlement infrastructure systems. It authorizes the Federal Reserve, the SEC, and the CFTC to prescribe risk

management standards for the conduct of "systemically important" payment, clearing and settlement activities conducted by financial institutions, as well as for the management of systemic risk in connection with significant infrastructure utilities.

Systemic importance, for purposes of this title, includes a situation in which 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 thus threatening the stability of the financial system. The Council is authorized to designate financial market utilities or payment, clearing, or settlement activities as systemically important, based on a consideration of: (1) the aggregate monetary value of processed transactions; (2) the aggregate exposure; (3) the relationships, interdependencies and interactions; (4) the effect of potential disruption; and (5) any other relevant factors. A designated utility or system may receive access to a Federal Reserve Bank account. It would also be subject to reporting and recordkeeping obligations as well as to examination (and potential enforcement action) by the Federal Reserve. The Council may rescind the designation of systemic importance after consultation with the relevant primary regulator and after notice and opportunity for hearing.

Subject to a number of exclusions, a financial market utility is essentially an 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."

Title VIII defines "payment, clearing, or settlement activity" to include "activities" carried out by one or more financial institutions "to facilitate the completion of financial transactions." It defines "financial institutions" to include, among other market participants, broker-dealers, investment advisers, and investment companies. It defines "financial transactions" to include a broad range of activities, many of which are essential to the broker-dealer and asset management industries. The definition includes funds transfers, securities contracts, futures, forwards, repurchase agreements, swaps, security-based swaps, swap agreements, security-based swap agreements, foreign exchange contracts, financial derivatives contracts, and any other transactions "determine[d] to be a financial transaction…" It also includes calculation and communication of unsettled financial transactions between counterparties, netting of transactions, provision and maintenance of information, risk management, payment instructions, fund movement, final settlement, and other "similar functions."

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

Title IX of the Act, the Investor Protection Title, addresses a wide range of issues relating to corporate governance, the functioning of securities markets, and the operation of the SEC.

1. Subtitle A: Increasing Investor Protection

One of the most contentious provisions addressed by the Conference Committee involved whether to impose similar standards of care on broker-dealers and investment advisers providing personalized investment advice to retail investors. A retail investor includes "a natural person, or the legal representative of such natural person who: (1) receives personalized investment advice about securities from a broker or dealer or (2) uses such advice primarily for personal, family or household purposes." The final provision reflects a compromise between the earlier House and Senate provisions and requires an SEC study and report on the current broker-dealer standard of care and on whether legal or regulatory gaps, shortcomings, or overlaps exist in the protection of retail investors. In conducting the study, the SEC is required to seek public comment and is also required to consider a number of factors, including, among other things, the effectiveness of existing standards and examinations, whether retail investors understand that different standards of care exist for broker-dealers and investment advisers, whether the existence of different standards is a source of confusion for retail investors, the substantive differences in regulation of broker-dealers and investment advisers, the varying levels of services provided by broker-dealers and investment advisers, and the potential effects and costs of potential changes to the standard of care. A separate section of the Act calls for an SEC study of whether enhanced examination and

enforcement resources are needed for investment advisers and whether investment advisers should be under SRO oversight.

The Act gives the SEC the discretion to begin a rulemaking after completion of the study and report as to the retail investor standard of care. The SEC is required in its rulemaking to consider the findings, conclusions, and recommendations of the study. If the SEC adopts a new broker-dealer and/or investment adviser standard of care, the Act specifies that it must be no less strict than the standard currently applicable to investment advisers under Sections 206(1) and (2) of the Investment Advisers Act of 1940 ("Advisers Act"). Rules, if adopted, also must require disclosure to the customer of any material conflicts of interest, and, for a broker-dealer that sells only proprietary or other limited range of products, the rules may require that the broker-dealer provide notice and obtain acknowledgment or consent of each retail investor. The Act also provides that the receipt of commission-based (or other "standard") compensation will not by itself be a violation of any new standard. Moreover, a broker-dealer will not be required to have a continuing duty of care or loyalty to a retail investor after providing the personalized investment advice.

Subtitle A also includes several investor-related initiatives, including the creation of a new Investor Protection Committee to advise and consult with the SEC on investor issues, a new Office of the Investor Advocate, and an Ombudsman to assist investors with SEC, SRO, and other securities-related issues. This subtitle expands the SEC's authority to engage in investor testing, including gathering information from the public and consulting with academics and consultants on investor issues. It further authorizes new point of sale investor disclosures for investment company products.

Finally, in addition to those discussed above, Subtitle A requires a number of other studies, including studies relating to: (1) financial literacy among investors and investor disclosure; (2) mutual fund advertising; (3) conflicts of interest between investment banking, equity research analyst, and fixed income research analyst functions; (4) improved investor access to information about investment advisers and broker-dealers; and (5) financial planners and the use of financial designations.

2. Subtitle B: Increasing Regulatory Enforcement and Remedies

Subtitle B of Title IX provides the SEC with enhanced tools to regulate the financial industry and to impose new penalties and collateral consequences for violations. The principal provisions are summarized below.

Collateral Actors and Consequences. Subtitle B includes many provisions requested by the SEC to assist in its enforcement of aiding and abetting securities violations through an expansion of the potential liability for collateral actors in a securities fraud. Under the Act, recklessness now satisfies the *mens rea* requirement for aiding and abetting cases brought by the SEC, overturning several circuit court decisions requiring the SEC to prove actual knowledge.[16] The Act also permits the SEC to impose joint and several liability on a person in control of a securities violator. In addition, this subtitle extends the SEC's aiding and abetting enforcement authority and the recklessness standard to the Securities Act, the Exchange Act,[17] the Investment Company Act, and the Advisers Act.

The Act also expands collateral consequences for violators of securities laws. Collateral bars are extended to prohibit a person subject to a bar from association with "a broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating

[16] The conferees rejected the controversial "Stoneridge Amendment," which was an attempt to overturn the Supreme Court's decisions in *Stoneridge Investment Partners v. Scientific-Atlanta*, 552 U.S. 148 (2008) and *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994). Those cases held that a private right of action is not available for aiding and abetting a securities violation under Section 10(b) and Rule 10b-5 of the Exchange Act. The conferees did include a requirement that the GAO study the impact of authorizing a private right of action for aiding and abetting.

[17] The Exchange Act already provides the SEC with enforcement authority for aiding and abetting. This subtitle expands the recklessness standard to the Exchange Act as well.

organization." In addition, within one year, the SEC must promulgate rules excluding "bad actors" from the safe harbor for private offerings under Rule 506 of Regulation D under the Securities Act. The regulations will prohibit issuers from relying on this exemption if they have previously violated a state or federal securities law or regulation. Considerable questions concerning the effect of this provision, including the extent to which waivers may be available, will remain open until final rules are promulgated by the SEC.

Whistleblower Awards and Expanded SEC Enforcement Authority. The Act increases the scope of the SEC's enforcement authority, including authorizing nationwide service of subpoenas. It creates a sweeping new provision designed to encourage whistleblower reporting. It requires that a fund be established to pay whistleblower awards of up to 30% of the monetary sanctions obtained by the SEC in a proceeding resulting form a whistleblower report. It also requires that the SEC establish a separate office with sole responsibility for addressing whistleblower concerns and enhances the SEC's ability to keep whistleblowers' identities confidential. The SEC is required to report annually to Congress on the effectiveness of its whistleblower program. The bill also amends the private right of action for whistleblowers enacted by Section 806 of the Sarbanes-Oxley Act to make clear that consolidated subsidiaries and affiliates of issuers are subject to claims by whistleblowers.

Information sharing between regulated entities, the SEC, and other domestic and international enforcement agencies is enhanced through greater protection from disclosure of the information shared by and with the SEC. The Act generally protects any information the SEC obtains from a regulated entity under the examination and oversight provisions of the Exchange Act, the Advisers Act, and the Investment Company Act from compelled disclosure. This provision, however, cannot be used as a basis for the SEC to withhold information from Congress, from another federal department or agency, or in complying with a court order in an action brought by the US. Subtitle B also protects the SEC and other federal, state, and foreign law enforcement and regulatory authorities from privilege waivers when exchanging information.

Partially reversing the Supreme Court's recently-decided *Morrison v. National Australia Bank* case,[18] the Act authorizes the SEC or the federal government to bring securities fraud cases in connection with extraterritorial conduct. The Act gives US district courts jurisdiction over suits brought by the SEC relating to: (1) "conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors"; and (2) "conduct occurring outside the United States that has a foreseeable substantial effect within the United States."[19]

Civil Penalties in Cease and Desist Proceeding. Subtitle B also expands the SEC's ability to recover monetary penalties for securities law violations. It permits the SEC to levy civil penalties against any party in an administrative cease and desist proceeding. Currently such penalties are only permitted against directly regulated entities and in limited circumstances, accounting firms. In addition, while the SEC is already permitted to seek monetary penalties in administrative proceedings against certain regulated entities under the Exchange Act, the Advisers Act, and the Investment Company Act, the Act permits the SEC to seek monetary penalties in administrative cease and desist cases without requiring a showing that the violation was willful.

Short Sale Reforms. The Act amends the Exchange Act to enhance the regulation of short sale transactions. It requires the SEC to promulgate rules requiring institutional investment managers to disclose information related to short sale transactions. The provision also calls for the SEC to promulgate rules to regulate and enforce manipulative short sales of securities. It requires that registered brokers or dealers notify their customers of the customer's right to disqualify their fully paid securities from use in short sales. In addition, if a broker or dealer lends a security not disqualified from short sales, the broker

[18] *Morrison v. National Australia Bank Ltd.* (Dkt. 08-1191).

[19] A provision that would have extended the "conduct and effects" test to allow for private rights of action failed in Conference Committee negotiations, leading to a compromise provision requiring the SEC to study the extent to which such private rights of action should be authorized under the Exchange Act.

or dealer must notify the customer that the broker or dealer may be compensated from the lending of the customers security.

Predispute Arbitration. The Act permits the SEC to regulate predispute arbitration clauses between regulated entities and their clients and customers. While the Act does not impose a timeline for the SEC to promulgate new regulations, it permits the SEC to prohibit or otherwise limit mandatory pre-dispute arbitration agreements if it is in the public interest and for the protection of investors.

3. Subtitle C: Improvements to the Regulation of Credit Rating Agencies

Subtitle C includes a number of amendments to the statutory oversight regime for credit rating agencies registered with the SEC as "Nationally Recognized Statistical Rating Organizations" ("NRSROs").[20] Two features of this subtitle that could have the biggest impact on the ratings industry are the civil liability provisions and the mandate for federal agencies to remove ratings references from their rules.

First, the Act will expose NRSROs to increased private liability.[21] It imposes a "knowing or reckless" pleading standard that is coupled with a due diligence duty requiring that NRSROs conduct a "reasonable investigation" and obtain a "reasonable verification" of relevant factual elements. It is not clear how burdensome this diligence standard will be compared to existing "best practices." The Act also: (1) clarifies that NRSROs are subject to liability "to the same extent as such provisions apply to statements made by a registered public accounting firm or securities analyst"; (2) provides that NRSRO statements are not forward looking for purposes of Section 21E of the Exchange Act; and (3) eliminates the rating agency exemption from Regulation FD.

In addition, Subtitle C eliminates references to ratings from federal statutes and requires that federal agencies remove references to ratings from their rules. Agencies are directed to eliminate the references and replace them with a "standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations." As evidenced by prior SEC rulemaking in this area, the creation of a new "standard of credit-worthiness" will not be an easy task, especially in areas such as broker-dealer capital and money market funds.

Subtitle C also drops the Senate Bill proposal for the establishment of a Credit Rating Agency Board (the "Franken Amendment") to assign ABS rating responsibility to NRSROs, establishing a qualification and evaluation process for rating agencies, and creating standards for ratings fees. However, the Act requires the SEC to study the feasibility of such a board and other similar rating agency systems, among several other mandated studies.

Subtitle C also requires NRSROs to have additional internal controls over the ratings process, and to submit to the SEC annual reports on compliance with securities laws and the NRSRO's policies and procedures. In addition, it specifies an annual cycle and minimum substantive requirements of SEC NRSRO examinations, and mandates SEC rulemaking on qualification standards for credit ratings analysts and ratings transparency. It also creates within the SEC a new Office of Credit Ratings, which will be a central office responsible for the entire SEC NRSRO oversight program. Various functions currently carried out in the Division of Trading and Markets and the Office of Compliance Inspections and Examinations will be consolidated into this new office, and the Director of the Office will report to the SEC Chairman.

4. Subtitle D: Improvements to the Asset-Backed Securitization Process

Subtitle D addresses the perceived need for securitizers of ABS to retain "skin in the game" in connection with the securitized assets. It contains a credit risk retention requirement of "not less than 5 percent," unhedged, for "securitizers" of "ABS." "ABS" and "securitizer" are both defined broadly in the Act in a way

[20] The Act does not make NRSRO registration mandatory for credit rating agencies.
[21] In addition to private liability measures, the Act increases SEC enforcement remedies as to NRSROs.

that could capture a large number of instruments and market participants that may not pose significant risk and that did not seem to play any meaningful role in the financial crisis.

The risk retention requirement, to be imposed through joint regulation of the OCC, the Federal Reserve, and the FDIC (collectively for purposes of this subtitle, the "federal banking regulators") and the SEC within 270 days of enactment of the Act, must require a securitizer to retain an economic interest in a portion of the credit risk for any asset that the securitizer, through the issuance of an ABS, transfers, sells, or conveys to a third party. The regulators may allocate the requirement between the securitizer and originator of the ABS and may also provide for a total or partial exemption from the requirement as may be appropriate in the public interest. In addition, the subtitle calls for a complete exemption for qualified residential mortgages, to be defined by the regulators, and for adjustments to the retention requirement (down to zero if appropriate) for commercial mortgages that satisfy certain enumerated standards. Different rules are required for different asset classes, and any class of assets or institutions may, if appropriate, be exempted or excepted from the retention requirement or the prohibition on hedging.

In addition to the retention requirement, Subtitle D requires two studies on ABS (one on the impact of the risk retention requirement to be conducted by the Federal Reserve in consultation with the SEC and the other federal banking regulators, and the other on the macroeconomic effects of the risk retention requirement to be conducted by the Council). It also requires disclosures and reporting for ABS, as well as new rules relating to due diligence by issuers of ABS.

5. Subtitles E and G: Accountability and Executive Compensation and Strengthening Corporate Governance

The Act includes new standards for public companies relating to corporate governance, executive compensation, and disclosure. Most of these provisions apply to all public companies, or to all exchange-listed companies, not merely to financial services firms. The key provisions include:

Proxy Access. The Act affirms the SEC's authority to issue a proxy access rule requiring company proxy materials to include shareholder nominees to the board of directors. The details of any such rule are left to the SEC's discretion. The Act allows the SEC to exempt small issuers from whatever rule is eventually promulgated. The SEC proposed to issue a proxy access rule in 2009, but its authority to do so was not clear. The Act does not specify any timetable for SEC action, but the SEC is expected to consider adoption of a new rule in the near term.

Say-on-Pay. Effective for a company's first shareholder meeting occurring six months after enactment, the Act will require a periodic, non-binding shareholder vote on compensation paid to company executives. The Act provides that this shareholder vote must take place at least once every three years, with the frequency of the votes to be determined by shareholder vote at least once every six years. In addition, a non-binding shareholder vote will be required, subject to certain exceptions, when a company seeks shareholder approval of a merger or acquisition transaction and executives receive compensation in connection with the transaction. The SEC may exempt small issuers and is directed to consider whether the say-on-pay and say-on-parachute requirements place an undue burden on them. Large institutional investment managers that are subject to reporting under Section 13(f) of the Exchange Act must disclose how they vote on say-on-pay or say-on-parachute matters.

Compensation Committee Independence and Responsibilities. The Act requires the SEC to require exchanges to adopt listing standards, within 360 days of enactment, requiring greater independence for compensation committees and promoting independence, and compensation committee oversight, of committee consultants, legal counsel, and other advisers. The SEC and exchanges will be able to issue exemptions if it finds them appropriate. This new requirement will not apply to controlled companies.

Clawbacks. Stock exchange listing standards will require companies to adopt and disclose incentive compensation clawback policies, under which, in the case of accounting restatements due to material

financial reporting non-compliance, the issuer may recover erroneously awarded incentive compensation received by executive officers during the three years prior to the restatement.

Broker Discretionary Voting. The Act will prohibit broker discretionary voting with respect to the election of directors (other than for uncontested elections to the boards of registered investment companies), executive compensation and any other significant matter as determined by the SEC. Since the exchanges have already eliminated discretionary voting in uncontested director elections, the most immediate consequence of this will be to prohibit discretionary voting on management say-on-pay proposals and cash compensation plans.

Disclosures. The Act requires the SEC, 180 days after the Act is enacted, to issue regulations requiring companies to disclose in proxy materials why they have chosen to have the CEO serve as chair of the board of directors, or not. Additionally, the Act calls for the SEC to promulgate a rule requiring companies to provide disclosures, which may include a chart, comparing the compensation paid to executives with the company's stock performance. The SEC will also require companies to disclose the median annual total compensation of all employees, except the CEO, in comparison with the CEO's compensation. Finally, the SEC must issue a rule requiring companies to disclose in proxy statements whether directors and employees are allowed to hedge against losses in the value of their company's securities.

Limit on Unsafe and Unsound Compensation. Within nine months after enactment, all relevant federal regulators jointly must promulgate regulations requiring financial institutions to disclose their incentive-based compensation structures to the appropriate regulator and prohibiting compensation structures that the regulators determine encourage inappropriate risks by providing excessive compensation or that could lead to material financial loss. The requirements do not apply to financial institutions with assets of less than $1 billion.

6. Subtitle F: Improvements to the Management of the SEC

Subtitle F of Title IX focuses on improvements to the management and administration of the SEC. It calls for a number of studies and reports to Congress, including: (1) an annual report and certification by the SEC's directors of the Divisions of Enforcement and Corporation Finance and the Office of Compliance Inspections and Examinations, subject to GAO review, on the agency's internal supervisory controls; (2) a GAO report every three years on personnel management, including talent management, promotion, competence, efficacy of communication, turnover, and other human resources initiatives and actions; (3) annual financial controls audit reports by the SEC and the GAO; (4) a report on oversight of registered national securities associations; (5) a comprehensive organizational study and report on the SEC by "an independent consultant of high caliber" with expertise in organizational restructuring; and (6) a GAO study on the "SEC revolving door" to determine the degree to which SEC employees leave to pursue employment at financial institutions regulated by the SEC. Finally, the subtitle also addresses a number of internal issues, such as providing authority for SEC inspections and examinations staff and requiring the SEC Inspector General to establish an employee suggestion hotline.

7. Subtitle H: Municipal Securities

Subtitle H includes several reforms to the municipal securities market. It requires registration and regulation of municipal securities dealers and "municipal advisors," which are defined as persons that provide advice to or on behalf of a municipal entity as to, among other things, municipal derivatives or investment strategies. The definition excludes a number of persons, including a broker-dealer or municipal securities dealer serving as an underwriter or any investment adviser registered under the Advisers Act and providing investment advice. The subtitle provides that municipal advisors owe a fiduciary duty to their municipal entity clients, and it also imposes liability on municipal advisors for fraudulent, deceptive, or manipulative acts or practices.

The subtitle changes the composition and terms of the 15-member MSRB to include eight "independent" public representatives and seven "regulated representatives," *i.e.,* individuals associated with a broker-

dealer, municipal securities dealer, or municipal adviser. It allows the MSRB to collect fees and establish "information systems" to serve as a repository of information about municipal market participants and creates an Office of Municipal Securities within the SEC. It provides for the involvement of the MSRB in SEC and registered securities association enforcement actions and examinations conducted pursuant to MSRB rules. It also calls for GAO studies on: (1) the disclosure made by municipal securities issuers; (2) trading mechanisms in the municipal securities markets; and (3) funding of the Government Accounting Standards Board ("GASB"). Finally, this subtitle provides for GASB funding through an "accounting support fee."

8. *Subtitle I: Public Company Accounting Oversight Board, Portfolio Margining, and Other Matters*

Among other things, this subtitle expands the scope of the PCAOB's regulatory authority to include accounting firms that audit broker-dealers that are not public companies. It also authorizes the PCAOB to provide confidential information to foreign accounting regulators. The subtitle exempts issuers that are not "large accelerated filers" or "accelerated filers" (defined in Exchange Act Rule 12b-2) from the requirement in Section 404(b) of the Sarbanes-Oxley Act that they obtain annual audits of internal control over financial reporting. The SEC and the GAO will also conduct studies to determine how the SEC could reduce the burden of Section 404 compliance and the impact of the Act's amendment of Section 404.

This subtitle also collects provisions relating to various other subjects. Among other things, it: (1) grants the SEC power to issue regulations regarding loans or borrowing of securities; (2) establishes a grant program to states and other eligible entities for programs to protect seniors from misleading or fraudulent marketing in the sale of or advice about financial products; (3) requires the GAO to do a study of proprietary trading by insured institutions, bank holding companies, financial holding companies, and other entities (the Volcker Rule in Title VI also deals with proprietary trading); (4) requires the GAO to conduct a study of person-to-person lending and the appropriate regulatory framework for it; (5) creates an exemption from the Securities Act for certain fixed income annuity products, thereby superseding SEC Rule 151A; and (6) creates a "Council of Inspectors General on Financial Oversight" of financial regulatory and certain other agencies, and makes certain other technical changes to the Inspector General Act of 1978 (in addition, Subtitle XV requires a GAO report on inspectors general).

9. *Subtitle J: SEC Match Funding*

Subtitle J in the Senate Bill originally provided for self-funding for the SEC. This would have allowed the SEC to determine its "obligations" and its "disbursements and expenses" independently and to collect fees from regulated entities. The compromise that resulted from the Conference process, however, leaves the SEC subject to the appropriations process, but it also provides for an increase in the resources available to the SEC and allows the SEC to submit its budget requests directly to Congress at the same time as the request is submitted to the President, presumably to protect the budget request from being reduced behind closed doors. The Exchange Act is amended to require the SEC to collect transaction fees and assessments "designed to recover the costs to the Government of the annual appropriation to the Commission by Congress." A new SEC "Reserve Fund," containing registration fees collected by the SEC up to $100 million, will be established at the Treasury Department and may be used by the SEC (in an amount up to $100 million per fiscal year) as it determines is necessary to carry out its functions.[22] The provisions of this subtitle will generally be effective on October 1, 2011 or later.

J. Title X: The Consumer Financial Protection Act of 2010

Title X creates a new autonomous agency called the Bureau of Consumer Financial Protection (Bureau) within the Federal Reserve imbued with broad powers over the regulation of consumer financial services. The Bureau is intended to regulate and enforce consumer financial protection laws in a fair and vigorous manner. The Bureau's jurisdiction includes exclusive rulemaking as well as more selective and (in some

[22] Congress has further limited the SEC's use of the Reserve Fund by restricting annual deposits therein to $50 million and by requiring the SEC to disclose to Congress, within 10 days, the purpose and amount of any obligations of the fund.

cases) concurrent supervisory and enforcement authority with respect to the so-called "enumerated consumer laws" as applied to "covered persons" offering "consumer financial product[s] or service[s]." As defined in Title X, the broad sweep of these terms serves to consolidate unprecedented federal consumer protection power in a single financial regulator.

1. Subtitle A: Bureau of Consumer Financial Protection

Subtitle A establishes the Bureau and its leadership and governance structure. Although the Bureau is situated within the Federal Reserve System and is funded through the Federal Reserve's budget, various protections insulate it from influence by the Federal Reserve. The President appoints the Director of the Bureau, who is subject to Senate confirmation. The Director may determine the percentage of the Federal Reserve's budget that is reasonably necessary for the Bureau to operate, up to a maximum of 13% in fiscal year 2013 and thereafter. Additionally, the Bureau has the authority to establish general policies regarding its executive and administrative functions. The Federal Reserve may not intervene in Bureau matters, including enforcement and examination actions, nor may it appoint or remove Bureau officers or employees, merge any aspect of Bureau business with that of the Federal Reserve, or prevent the issuance of Bureau rules.

Subtitle A creates specific functional units within the Bureau to manage research, complaints, and community affairs. It establishes offices in the agency, such as the Office of Fair Lending and Equal Opportunity, the Office of Financial Education, the Office of Service Member Affairs, and the Office of Financial Protection for Older Americans. In addition, it directs the Bureau to commission a study on financial literacy. Subtitle A sets up a Consumer Advisory Board that will consult with the Bureau on its duties under consumer financial protection laws and will provide information on emerging markets in the industry. The Bureau is also required to coordinate with other federal agencies and state regulators in order to "promote consistent regulatory treatment of consumer financial and investment products and services."

2. Subtitle B: General Powers of the Bureau

Subtitle B delineates the objectives and general powers of the Bureau. The Bureau's objectives include promoting financial education, investigating consumer complaints, conducting market research, rulemaking, supervising and examining covered persons, and enforcing rules related to consumer financial products and services.

The Bureau is granted exclusive authority to issue regulations, orders, and guidance implementing federal consumer financial law. The Bureau's exclusive rulemaking authority allows it to issue rules applicable to all financial institutions – including non-depository institutions (non-banks) and depository institutions (mainly banks) – offering consumer financial services or products. The Bureau also has the authority to exempt covered persons, service providers, or consumer financial products or services from Title X's provisions and rules issued under the title. Subtitle B directs the Bureau to use its exemption authority when it determines it is necessary or appropriate to achieve the purposes and objectives of the title. When doing so, Subtitle B requires the Bureau to look at factors including assets, transaction volume, and existing applicable consumer financial protection laws with respect to the persons under consideration for exemption. Courts are to treat the Bureau's interpretations of consumer financial law with deference as if the Bureau were the only entity with the authority to "apply, enforce, interpret or administer" the relevant provision.

Subtitle B allows the Council to veto Bureau regulations. If petitioned by a federal prudential regulator, the Council may temporarily stay or permanently set aside a Bureau regulation, depending on a two-thirds vote by Council members. Any such decision by the Council must be grounded in a finding that the regulation poses a risk to the stability of the financial system of the United States or to the safety and soundness of the US banking system. Additionally, Subtitle B requires the Bureau to acknowledge the written objection of any prudential regulator in the written release when adopting a particular rule. Subtitle

B grants the Bureau the authority to collect information relating to the organization, business conduct, markets, and activities of covered persons and service providers.

The Bureau is also tasked with supervising and examining certain covered persons for compliance with federal consumer financial law and enforcing such laws. The Bureau's supervision and enforcement powers depend on the type of activity engaged in by the covered person and whether the covered person is a depository institution with more than $10 billion in assets (so-called "very large" institutions) or $10 billion or less in assets.

The Bureau is empowered to supervise and examine the following types of non-depository institutions and their service providers:

- Providers of consumer mortgage origination, brokerage, servicing, loan modification or foreclosure relief services;
- "[L]arger participants of a market for other consumer financial products or financial services," which are to be defined by Bureau rule;
- Those the Bureau has reasonable cause to determine are engaged in conduct that "poses risks to consumers" in providing consumer financial products or services;
- Those who "offer or provide" private education loans; and
- Those who "offer or provide" payday loans.

The Bureau has exclusive supervisory authority over such non-depository institutions. This authority obliges the Bureau to conduct periodic examinations, assess compliance, collect information about an entity's compliance procedures, and detect and assess risks to consumers and markets. Moreover, this supervisory authority must be exercised on the basis of the Bureau's assessment of the risks posed to consumers by conduct in the relevant markets and requires the Bureau to coordinate such supervisory efforts with the efforts of prudential and state banking regulators. The Bureau must use existing reports provided by other state and federal agencies and publicly reported information to the fullest extent possible in conducting examinations.

The Bureau's enforcement authority is similarly limited to exclusive enforcement authority over federal consumer financial law pertaining to the types of non-depository institutions listed above. Other federal agencies may recommend enforcement actions to the Bureau, if the recommending agency has been authorized to conduct the enforcement proceedings itself. The Bureau must negotiate an agreement with the Federal Trade Commission ("FTC") to coordinate enforcement actions against these types of non-depository institutions. The Bureau and the FTC have concurrent authority to bring civil actions in federal district court or state court for legal and equitable relief in the event of violations.

The Bureau has exclusive supervisory power with respect to federal consumer financial laws over "very large" insured depository institutions and credit unions (defined as those with assets over $10 billion) and their affiliates and service providers. As with the selected non-depository institutions, the Bureau is charged with supervising and examining for compliance, collecting information concerning compliance procedures, and detecting and assessing risks. The Bureau is also required to coordinate its supervisory efforts with prudential and state banking regulators, as applicable, and to make use of existing reports and publicly-available information to minimize regulatory burdens. Prudential regulators and the Bureau are to coordinate the scheduling of examinations (which are to be simultaneous unless the institution requests otherwise), share draft reports of examination, and take into account comments of one another before issuing a final report or taking supervisory action. Detailed provisions apply to address potential conflicts in supervisory findings between the Bureau and the prudential regulator, including the availability of an appeal process for the affected depository institution.

The Bureau also has primary enforcement authority with respect to these very large depository institutions concerning federal consumer financial laws. Federal prudential regulators may recommend enforcement actions to the Bureau, if the recommending federal agency has been authorized to conduct the enforcement proceedings itself. The recommending federal agency may exercise its backup enforcement authority, if the Bureau does not initiate enforcement proceedings within 120 days from receipt of the recommendation. Subtitle B also directs the Bureau to coordinate with state bank regulators in these activities.

The Bureau has much less potent supervisory and enforcement powers over smaller insured depository institutions and credit unions (defined as those with assets of $10 billion or less) and their service providers. The Bureau may include examiners on a "sampling basis" with the examinations performed by the prudential regulator in order to assess compliance with federal consumer financial law. In doing so, the Bureau may require reports from smaller insured depository institutions. The prudential regulator, however, has the exclusive authority to enforce the provisions of federal consumer financial laws for such institutions. In the event of a material violation of consumer financial law, the Bureau has the authority to notify the prudential regulator and recommend appropriate action.

Subtitle B also excludes numerous categories of businesses from the Bureau's jurisdiction. The major exclusions include:

- Merchants, retailers, and other sellers of non-financial goods or services to the extent engaged in the sale or brokerage of non-financial goods or services or extending credit or collecting or selling debts arising from such sale (subject to limitations and a small business exception);
- Licensed or registered real estate agents and brokers engaged in brokerage activities;
- Brokers of manufactured or modular homes;
- Accountants and tax preparers;
- Lawye rs;
- Persons regulated by state insurance regulators;
- Employee benefit and compensation plans and certain other arrangements under the 1986 Internal Revenue Code;
- Persons regulated by a state securities commission or the Securities Exchange Commission;
- Persons regulated by the Commodity Futures Trading Commission or the Farm Credit Administration;
- Persons engaged in activities related to the solicitation or making of charitable contributions; and
- Auto dealers.

These exclusions in many cases are subject to individual qualifications and limitations. Subtitle B also sets forth other powers and limitations for the Bureau, such as the power to restrict mandatory pre-dispute arbitration and a prohibition on establishing a usury limit.

3. Subtitle C: Specific Bureau Authorities

Subtitle C establishes substantive standards for the Bureau's rulemaking authority. The Bureau may prescribe rules to address unfair, deceptive, or abusive acts or practices in connection with the provision of consumer financial products and services. These standards are generally similar to those found in FTC interpretations and the FTC Act, and the subtitle specifies statutory standards for findings of unfairness or abuse. The standard for unfairness is similar to that in the FTC Act: An "unfair" act or practice causes substantial consumer injury that is not reasonably avoidable by consumers and which is not outweighed by benefits to consumers or to competition. The Bureau needs only a "reasonable basis" to conclude that the above conditions are met. For the Bureau to declare an act or practice "abusive," it must materially interfere with a consumer's ability to understand a term or condition of a consumer financial product or service, or it must take "unreasonable advantage" of a consumer's lack of understanding, inability to protect his or her interests, or reasonable reliance on a covered person to act in the consumer's interest.

Subtitle C also empowers the Bureau to make rules in order to ensure the features of consumer financial products and services are "fully, accurately and effectively" disclosed to consumers, including the power to create model disclosures. The subtitle renders unlawful any act or omission in violation of a federal consumer financial law or engaging in any unfair, deceptive or abusive act or practice. Persons "knowingly or recklessly" providing "substantial assistance to a covered person" in connection with such conduct are also liable.

Finally, Subtitle C establishes consumer rights to information from covered persons, requires the Bureau to respond to consumer complaints, and establishes a private education loan ombudsman within the Bureau.

4. Subtitle D: Preservation of State Law

Subtitle D addresses the interaction between Title X, and its associated regulations, and state law. Title X only preempts state law provisions to the extent they are inconsistent with the title, as determined by the Bureau. A state law is not inconsistent if it affords greater consumer protection than that offered by Title X. In addition, Title X does not modify, limit or supersede, with one limited exception, the operation of any enumerated consumer law that relates to the application of an existing state law. The Bureau is required to issue a notice of proposed rulemaking if a majority of states support the establishment or modification of a consumer protection regulation by the Bureau.

State regulators, after notifying the Bureau and any prudential regulator, may bring civil actions or other proceedings to enforce provisions of Title X or regulations issued under Title X against state-chartered or state-licensed institutions. State attorneys general cannot bring civil actions to enforce the provisions of Title X against national banks or federal savings banks, but may bring actions to enforce Bureau regulations issued under the title. The Bureau may intervene in any such action against either state or federally-chartered institutions.

Importantly, although the subtitle rolls back some of the OCC's preemption rulings, it explicitly preserves national bank interest rate preemption, providing that nothing in the subtitle shall be regarded as "altering or otherwise affecting" the authority conferred by 12 U.S.C. 85 for the charging of interest by a national bank "…including with respect to the meaning of 'interest' under such provision.' This appears to be a reference to the Supreme Court's decision in *Smiley v. Citibank,* which approved an OCC regulation that includes certain fees within the definition of "interest."[23]

The subtitle amends the National Bank Act and the Home Owners Loan Act to harmonize the standard for federal preemption of state law as applied to national banks and federal savings banks. The new preemption standard provides that state consumer financial laws are preempted only if: (1) the application of the state law would have a discriminatory effect on the federally-chartered institution, as compared to

[23] *Smiley v. Citibank*, 517 U.S. 735 (1996).

state-chartered institutions; (2) in accordance with the standard articulated by the Supreme Court in *Barnett Bank*, to the extent the state law "prevents or significantly interferes with the exercise by the national bank of its powers," as determined by a court or, when supported by substantial evidence, by the OCC; [24] or (3) the state law is preempted by federal law other than Title X. The OCC must periodically review each preemption decision through notice and public comment every five years and determine whether to continue or rescind the determination.

Subtitle D also provides that a state's consumer financial law applies to a national bank or federal savings bank's subsidiary or affiliate in that state, other than one that is itself a national bank or federal savings bank, to the same extent that it would apply to any other person subject to the state law. This section implicitly overrides *Watters v. Wachovia Bank*, in which the Supreme Court held that state-chartered operating subsidiaries of national banks are subject to OCC regulation and not regulation by the states in which they are located.[25] Finally, the subtitle amends the National Bank Act to provide that no limits or restrictions on the exercise of visitorial powers against national banks are to be construed as limiting or restricting the authority of any state attorney general to bring an action in court against a national bank. The subtitle explicitly provides that this visitorial powers amendment is "in accordance with" the decision of the Supreme Court in *Cuomo v. Clearing House Assn.*[26]

5. Subtitle E: Enforcement Powers

Subtitle E sets forth the general enforcement powers of the Bureau, which may conduct investigations to determine if there has been a violation of a federal consumer financial law. In conducting investigations, the Bureau has the authority to issue subpoenas, demand documents, and conduct other administrative discovery. The Bureau may conduct hearings and adjudication proceedings to enforce this title or any enumerated consumer law and accompanying regulations.

Following notice and hearing, the Bureau may issue cease and desist orders against any covered person that, "in the opinion of the Bureau," is violating a Bureau law, rule, or written condition. Cease and desist orders are generally effective 30 days after service, but the Bureau can also issue temporary cease and desist orders effective immediately if it determines that a continuing violation is "likely to cause the person to be insolvent or otherwise prejudice the interest of consumers." Appeals from Bureau determinations are made directly to the US Court of Appeals.

Subtitle E also grants the Bureau a broad range of litigation powers. In general, if the Bureau finds a covered person in violation of a federal consumer financial law, it may commence civil actions in its own name to seek civil monetary or equitable relief (but not punitive damages). (*See* discussion of the limitations on the Bureau's enforcement jurisdiction in Subtitle B, above). The Bureau must notify the US Attorney General or prudential regulator (as applicable) before commencing a civil action. Finally, Subtitle E provides a general three year statute of limitations for Bureau civil actions, beginning from the date of discovery.

Together with other relief, such as rescission or reformation of contracts, refunds, disgorgement, and restitution, Subtitle E authorizes the Bureau to impose three tiers of civil monetary penalties, ranging from $5,000 to $1 million per day for each violation.

6. Subtitle F: Transfer of Functions and Personnel and Transition Provisions

Subtitle F provides for the transfer of consumer financial protection authorities and personnel from various federal agencies. The Secretary of the Treasury and heads of various federal agencies must establish a "designated transfer date" for the transfer of such functions within 60 days after enactment of the Act. On the designated transfer date, the Bureau receives the transfer of all consumer financial protection functions and all identified employees necessary to perform or support those functions from several

[24] *Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner, et al.,* 517 U.S. 25 (1996).
[25] *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1 (2007).
[26] *Cuomo v. Clearing House Assn. L.L.C.*, 129 S. Ct. 2710 (2009)

federal agencies, including the Federal Reserve, the FDIC, the OCC, the OTS, the NCUA, and the Department of Housing and Urban Development ("HUD"). The designated transfer date must be between 180 days and 12 months after enactment of the Act, subject to extension to a maximum of 18 months upon a written determination of necessity by the Secretary of the Treasury.

Subtitle F provides special transfer rules for the FTC and prudential regulators of depository institutions. Only the general rulemaking power and power to conduct studies or issue reports are transferred from the FTC, nor is there any mandatory transfer of employees from the FTC. The FTC also retains its power under the FTC Act to regulate unfair and deceptive acts or practices in or affecting commerce, and Subtitle F directs the FTC and the Bureau to negotiate an agreement regarding their overlapping rulemaking authority to avoid duplication or conflict. The FTC and the Bureau also share concurrent enforcement authority over covered persons subject to FTC jurisdiction under the FTC Act. Finally, the subtitle reserves for prudential regulators of depository institutions the authority necessary to exercise their exclusive or backup supervisory or enforcement obligations, as described in Subtitle B.

7. Subtitle G: Regulatory Improvements

Subtitle G incorporates the "Durbin Amendment," which amends the Electronic Funds Transfer Act ("EFTA") to require that interchange transaction fees that are charged by an issuer with respect to an electronic debit transaction – fees established, charged, or received by a payment card network for the purpose of compensating an issuer for its involvement in an electronic debit transaction – be "reasonable and proportional to the cost incurred by the issuer with respect to the transaction." The subtitle directs the Federal Reserve to prescribe regulations within nine months of enactment to define "reasonable and proportional." The Federal Reserve may allow an adjustment to the fee amount to compensate issuers for the costs of fraud prevention. Issuers that have, together with their affiliates, less than $10 billion in assets are exempt from these provisions. The subtitle also exempts government-administered payment programs (for debit cards as well as general-use prepaid cards) and reloadable prepaid cards, provided that, after a two-year grace period, cardholders are not charged fees for overdrafts or the first monthly in-network ATM withdrawal. The Federal Reserve also is granted more general authority to prescribe regulations over network fees. However, this authority is limited to ensuring that the network fee is not being used to compensate an issuer for an electronic debit transaction or to evade the interchange fee provisions of the amendment.

Also as part of the Durbin Amendment, Subtitle G requires the Federal Reserve, within a year of enactment of the Act, to issue regulations concerning certain credit and debit transaction network restrictions. The regulations must prohibit issuers or payment networks from restricting electronic debit transaction processing to one network or two or more affiliated networks. Acceptors of payment cards are expressly permitted to provide discounts to use either cash, check, or payment cards, so long as the discount does not differentiate as between issuers or between payment card networks. Further, merchants are authorized to set a minimum dollar value of up to $10 for credit card transactions, provided again such minimum value is applied equally to all issuers or payment networks.

The Federal Reserve, and not the Bureau, retains exclusive rulemaking and enforcement authority over provisions in the Durbin Amendment. The Bureau will have such authority over the remainder of the EFTA.

Subtitle G also incorporates a version of the "Udall Amendment," first passed by the Senate, which mandates that numerical credit scores be disclosed to consumers in adverse action notices required under the Fair Credit Reporting Act. The Senate did not vote on a version of the Udall Amendment that would have allowed individuals to receive a free copy of their credit score each year.

Finally, Subtitle G includes other miscellaneous regulatory changes. For example, through amendments to EFTA, Subtitle G mandates that remittance transfer providers make various disclosures to the sender regarding the transfer at the time of initiation and payment, including the sender's rights regarding error resolution. The Bureau must prescribe rules and standards for certain remittance transfer providers and

conduct studies regarding other remittance transfer providers for the purpose of determining other relevant rules. Subtitle G also authorizes various studies, for example concerning reverse mortgages, private education loans and lenders, and options for ending the conservatorship of Fannie Mae and Freddie Mac.

8. Subtitle H: Conforming Amendments

Subtitle H amends existing laws to reflect the existence and powers of the new Bureau.

K. Title XI: Federal Reserve System Provisions (Including FDIC Provisions from other Titles)

Title XI, similar to what was in the Senate Bill, grants the Federal Reserve and the FDIC substantial economic stabilization powers but only for use in broad-based programs. The powers may not be used to assist individual financial firms and must meet a number of policy, procedural, and regulatory controls. These economic stabilization powers are also subject to measures providing for transparency.

1. Federal Reserve Emergency Lending Authority

The Federal Reserve is authorized to use emergency lending powers under Section 13(3) of the Federal Reserve Act, but only for broad-based programs and facilities. The Federal Reserve may not use emergency lending powers for individual firms or entities. All participants in the broad-based programs established under 13(3) authority must be solvent and must provide sufficient collateral to protect taxpayers from losses. The Federal Reserve may not establish 13(3) programs without the prior approval of the Secretary of the Treasury.

The Federal Reserve is instructed to promptly promulgate regulations to establish policies and procedures to require that Federal Reserve Banks assure that participants in 13(3) programs are solvent and that collateral is sufficient to ensure protection of taxpayers from losses, as well as to ensure that the purpose of any 13(3) program is to provide liquidity to the financial system, not to bailout particular entities.

Within seven days of authorizing a loan or other financial assistance under Section 13(3), the Federal Reserve must provide the Senate Banking, Housing, and Urban Affairs Committee and the House Financial Services Committee with information on the assistance, including the justification for the assistance, amount and material terms of the assistance, identity of the borrower, information about the collateral, and cost to the taxpayer. Written updates must be provided every 30 days, with respect to any such outstanding loan or financial assistance. The Federal Reserve may request that the disclosure be kept confidential, in which case disclosure will be limited to the Chairs and Ranking Members of the respective committees.

If an entity receiving assistance from the Federal Reserve under a 13(3) program becomes subject to the orderly liquidation authority established in Title II of this Act, the Federal Reserve's claim to the amount of the net realized loss against the covered entity will have the same priority as the entity's obligation to the orderly liquidation fund and orderly liquidation assessments.

2. FDIC Guarantee Authority: Emergency Liquidity

Similar to the Federal Reserve's 13(3) authority, the title provides the FDIC with guarantee authority for broad-based programs to provide emergency liquidity to the financial system, so long as strict policy, procedural, and regulatory requirements are met. The FDIC's guarantee authority may only be used for widely-available programs for solvent depository institutions and their holding companies, and only in response to a liquidity event. This section precludes the FDIC's use of previously existing authority to establish a widely-available debt guarantee program.

The FDIC may only use this new broad-based guarantee authority after a written determination of a liquidity event is approved by two-thirds of the FDIC and the Federal Reserve, with the concurrence of the Secretary of the Treasury, in consultation with the President. The determination must establish that there is a liquidity event posing "serious adverse effects on financial stability or economic conditions" necessitating the use of the FDIC's guarantee authority. Two situations will be considered liquidity events: (1) "an exceptional and broad reduction in the general ability of financial market participants to sell financial assets without an unusual and significant discount; or to borrow using financial assets without an unusual and significant increase in margin," or (2) "an unusual and significant reduction in the ability of financial market participants to obtain unsecured credit." The determination is subject to GAO review. Congress must be informed within 30 days, or as quickly as the maximum guarantee amount is submitted to Congress for approval.

Once a determination is made requiring FDIC authority to respond to a liquidity event, the FDIC must create a widely-available program. Participants in the program must be solvent insured depository institutions or holding companies of such institutions.

The maximum amount of debt the FDIC can guarantee must be set by the Secretary of the Treasury in consultation with the President and approved by Congress. Congress must approve the maximum amount by joint resolution and consideration is subject to fast track procedures in the Senate. Fast track procedures authorized by the Act include limits on debate, amendment, and various other procedures ensuring prompt consideration. Any increase to an approved maximum guarantee amount must be approved through the same process.

The FDIC, in consultation with the Secretary of the Treasury, is directed to promulgate regulations setting forth the polices and procedures for issuance of guarantees, including collateral requirements. The FDIC will set terms and conditions of the guarantees with the agreement of the Secretary of the Treasury.

The FDIC may borrow funds from the Secretary of the Treasury to carry out an emergency liquidity guarantee program, so long as such funds are repaid with interest by the FDIC. The FDIC will charge fees and other assessments to recover losses and administrative expenses, and may impose special assessments on participants if needed to cover losses or expenses. These assessments may also be used to repay the Treasury Department.

If a participant defaults on obligations guaranteed by the FDIC, the FDIC will appoint itself receiver for the defaulting insured depository institution and require defaulting participants that are not insured depository institutions to file for bankruptcy or be wound down under the orderly liquidation authority set forth in Title II of the Act.

3. Federal Reserve Governance

Title XI proposes changes to the structure and authority of the Federal Reserve to improve the Federal Reserve's supervision of regulated entities and promote financial stability.

The title establishes a Vice Chair of Supervision of the Federal Reserve, who will be designated by the President with the advice and consent of the Senate. The Vice Chair of Supervision will make policy recommendations for the Board on the supervision and regulation of depository institution holding companies and other financial services firms overseen by the Federal Reserve, will oversee the supervision and regulation of such firms, and report semi-annually to Congress.

The title amends the mission of the Federal Reserve to include the identification and mitigation of risks to financial stability. The Federal Reserve may not delegate this financial stability authority, nor supervisory policymaking authority, to the Federal Reserve Bank Presidents.

The title limits the role of banks in voting for the Federal Reserve Bank Presidents by preventing Class A Federal Reserve Bank Directors (elected to represent member banks) from voting for Federal Reserve

Bank Presidents. Only Class B and C Federal Reserve Bank Directors (selected to represent the public) will be authorized to vote for Federal Reserve Bank Presidents. Current or former directors, officers, or employees of entities regulated by the Federal Reserve are still eligible to serve as Federal Reserve Bank Directors, but the GAO is instructed to study whether this practice creates actual or potential conflicts of interest.

The title does not change the process of appointment of the President of the New York Federal Reserve.

4. Public Disclosure and Transparency Measures

Title XI also provides for increased transparency through disclosure of information about emergency lending practices.

In particular, the GAO is required to conduct a one-time audit of all Section 13(3) emergency lending that took place between December 1, 2007 and the date the bill is enacted. The audit is to begin within thirty days of enactment and to be completed within twelve months. The GAO will report its findings to Congress. The GAO is also directed to complete an audit of the governance of the Federal Reserve System within a year of enactment of the Act.

In addition, the Federal Reserve must publish on its website information on all loans and financial assistance made between December 1, 2007 and the date the bill is enacted. The information must be posted by December 1, 2010 and will include the identity of recipients, the type of assistance, the value or amount of the assistance, the date provided, terms of repayment, and the rationale for each facility or program.

5. Disclosure of Future Assistance

The GAO is granted ongoing authority to conduct reviews of Section 13(3) emergency lending credit facilities, open market operations, and discount window transactions that are covered transactions under new Section 11(s) of the Federal Reserve Act. Within 90 days of completion, the GAO must report to Congress on its findings, without disclosing the names, amounts borrowed, or identifying details of borrowers or of the assets or collateral held by a credit facility. Credit facilities will be considered terminated two years after ceasing to extend credit and loans, and non-redacted versions of the GAO reviews must be released one year after termination.

The Federal Reserve is instructed to make a variety of information on emergency assistance publicly available on its website for at least six months after it is released. Such information includes GAO reports on 13(3) credit facilities, open market operations, and discount window transactions, as well as financial statements prepared for the Federal Reserve by independent auditors and reports to the Senate Banking, Housing, and Urban Affairs Committee.

L. Title XII: The Improving Access to Mainstream Financial Institutions Act of 2010

Title XII of authorizes the creation of multi-year grants, cooperative agreements, financial agency agreements and other programs to assist low- and moderate-income individuals to establish deposit and other types of accounts with mainstream financial institutions, such as banks and credit unions. Title XII also authorizes the establishment of programs to encourage low-cost alternatives to what are characterized as high-cost small dollar loans (such as payday loans) otherwise available in the market. Entities eligible to participate in the grants and programs under Title XII are limited to 501(c)(3) organizations, federally insured depository institutions, community development financial institutions, and state, local or tribal government entities, as well as partnerships or joint ventures comprised of such entities.

Title XII also authorizes the Community Development Financial Institutions Fund to make grants to community development financial institutions to help defray the costs of operating small dollar loan programs. Small dollar loans are loans that are made in amounts not exceeding $2,500, must be repaid in

installments, have no pre-payment penalty, for which the lending institution must report payments to at least 1 consumer reporting agency, and which meet any applicable affordability requirements. Again, the purpose of allowing such grants is to encourage community development financial institutions to maintain small dollar loan programs to compete with the more costly small dollar loans currently available to low- and moderate-income individuals.

M. Title XIII: The Pay it Back Act

Title XIII amends Section 115(a) of the Emergency Economic Stabilization Act of 2008 ("EESA") to reduce the amount of TARP funds available to the Secretary of the Treasury. Section 115(a) was amended during last-minute Conference Committee negotiation on the "bank tax" (*see* the discussion of Title III, above), to shorten the end date of TARP programs by providing that no TARP obligation may be incurred for any program or initiative that was not started before June 25, 2010. This title also mandates that revenue from the sale by the Treasury Department of Fannie Mae, Freddie Mac, or Federal Home Loan Bank obligations and securities must be used solely for deficit reduction and may not be used to offset other spending increases or revenue reductions.

N. Title XIV: The Mortgage Reform and Anti-Predatory Lending Act

Title XIV makes significant changes to mortgage financing rules through amendments to the Truth in Lending Act ("TILA") and other existing laws. It aims to restrict abusive practices and mortgage terms in residential mortgage origination and lending and to prevent borrowers from entering into mortgages that they cannot reasonably repay. Nearly all the substantive provisions of Title XIV are deemed "enumerated consumer laws" which come under the purview of the new Bureau, giving the Bureau rulemaking authority, and in many cases supervisory and enforcement authority, over this title. For depository institutions with assets of $10 billion or less, supervisory and enforcement authority remains with the institutions' prudential regulator. (*See* discussion of Title X, Subtitle B, above.) Title XIV also doubles the civil penalties for TILA violations and extends from one to three years the statute of limitations for violations of Subtitles A and B relating to origination and minimum standards for residential mortgages.

Title XIV was originally passed by the House in May 2009 as the Mortgage Reform and Anti-Predatory Lending Act of 2009 and was then included in the House Financial Reform Bill. The Senate Bill contained no direct analogue to this title, but it did include in its Bureau Title several provisions from the House Bill relating to mortgage origination and underwriting standards.

1. Subtitle A: Mortgage Loan Origination Standards

Subtitle A of Title XIV restricts the conduct of residential mortgage "originators," defined as those who assist a consumer in obtaining a mortgage, such as by taking mortgage applications or negotiating mortgage terms. "Steering incentives," or payments to mortgage originators that vary based on any loan term besides amount of principal, are banned. Subtitle A also directs the Bureau to issue regulations that prohibit mortgage originators from steering consumers to mortgages that the customer lacks a reasonable ability to repay or have "predatory characteristics or effects," such as excessive fees or abusive terms, and to prohibit originators from steering customers from a "qualified mortgage" to a non-qualified mortgage (as defined below). Mortgage originators are also prohibited from receiving variable compensation based on factors other than the size of the loan (so-called "yield spread premiums"), or mischaracterizing the borrower's credit or the value of the property securing the loan. Mortgage originators in violation of this subtitle may be liable to a consumer for up to the greater of actual damages or three times any gain from the mortgage, plus attorneys' fees.

Further, Subtitle A grants the Bureau broad discretionary rulemaking authority to prohibit any residential mortgage terms, acts, or practices that it finds abusive, unfair, deceptive, predatory, or "not in the interest of the borrower," and to condition mortgages on terms that it finds "necessary and proper" to ensure that responsible mortgage credit remains available to consumers.

2. *Subtitle B: Minimum Standards for Mortgages*

The heart of Title XIV is found in Subtitle B, which prescribes numerous minimum underwriting standards, prohibited practices, and mandatory disclosures for residential mortgages. Most notably, Subtitle B prohibits a creditor from making a residential mortgage loan, except for certain refinancings, reverse mortgages, and bridge loans, unless the creditor "makes a reasonable and good faith determination, based on verified, documented information, that the consumer has a reasonable ability to repay" the loan. The requirement is an attempt to ban most "stated-income loans," in which borrowers offer no proof of their ability to make payments. Instead, creditors must consider the applicant's credit history, current and reasonably assured expected income, and other enumerated factors, and verify income or assets using "reasonably reliable" third-party documentation, such as tax returns, bank records, or payroll receipts. Creditors are permitted to presume the borrower has the ability to repay if the mortgage is a "qualified mortgage" that meets certain consumer-friendly criteria (some of which are to be defined by regulations). Although such "qualified mortgages" require the creditor to "document and verify" the income and financial resources relied upon to qualify the borrower, the creditor is not obliged to consider the enumerated statutory underwriting factors or review third-party documentation. The definition of "qualified mortgage" serves as the upper-bound for the future definition by regulators of a "qualified residential mortgage," which will be exempt from the credit risk retention requirements in Title IX; a qualified residential mortgage cannot be defined more broadly than a qualified mortgage. (*See* discussion of Title IX, Subtitle D, above.)

Subtitle B also prohibits a variety of mortgage-related practices, including: single premium credit insurance, mandatory arbitration, and most prepayment penalties. The subtitle also mandates specific prior disclosures for mortgages that may result in negative amortization. Title XIV further restricts residential mortgages that are not "qualified mortgages," defined generally as mortgages in which regular periodic payments of principal do not increase the principal balance, that exclude balloon payments, for which the creditor has verified and documented the borrower's ability to repay, and which have interest rates and fees under certain thresholds. Even where a prepayment penalty is permitted, the creditor must also offer the borrower an alternative loan product that does not have such a penalty. Non-qualified mortgages may not have prepayment penalties and are less likely to meet certain exemptions from Title XIV's prohibitions and minimum standards. The borrower can use violation of the provisions in Subtitles A or B as a defense to foreclosure by recoupment or set off.

Subtitle B requires creditors to make various disclosures before extending residential mortgage credit, including total settlement charges, fees to mortgage originators paid in connection with the loan, and the total interest payable over the life of the loan. For variable rate mortgages, creditors must disclose the initial monthly payment and the monthly payment amount due using the "fully indexed" rate, which includes the margin that will apply after the expiration of any introductory interest rates. The subtitle also requires various disclosures to be made in periodic statements each billing period and directs the Bureau to develop a standard form for such statements. Finally, the subtitle requires the GAO to study the effects the Act will have on availability and affordability of credit for consumers, small businesses, homebuyers, and mortgage lending, and to analyze the Act's credit risk retention provisions on lender funding and capital reserves and on risks to the larger credit market created by the repackaging and selling of securitized loans. The GAO must report its findings within one year of the Act's enactment. (*See* discussion of Title IX, Subtitle D, above.)

3. *Subtitle C: High-Cost Mortgages*

Subtitle C creates additional consumer protections and disclosure requirements for "high-cost" mortgages, defined by reference to the fees or the interest rate charged for the mortgage, by strengthening the Home Ownership and Equity Protection Act ("HOEPA"). The subtitle lowers HOEPA's thresholds for high-cost mortgages and provides that creditors may not extend consumer credit under a high-cost mortgage unless the consumer has first received independent counseling on the advisability of the mortgage. Subtitle C bans balloon payments on high-cost mortgages and prohibits high-cost mortgage creditors from charging fees for providing payoff statements, financing points and fees, or recommending or

encouraging default on an existing loan if the high-cost mortgage refinances that loan. The subtitle also restricts late fees and acceleration of debt for high-cost mortgages.

4. Subtitle D: Office of Housing Counseling – the "Expand and Preserve Home Ownership Act"

Subtitle D establishes the Office of Housing Counseling ("OHC"), as part of HUD, to conduct homeownership and rental counseling relating to mortgage loans. Homeownership counseling must cover the entire process of homeownership, including: the decision to purchase a home; the selection and purchase of a home; issues arising during homeownership, such as refinancing; default and foreclosure; and the sale or disposition of a home. The subtitle requires the OHC to: (1) conduct an education program relating to predatory lending practices and scams in areas with a high density of foreclosure; (2) launch a national campaign promoting homeownership counseling directed at potentially vulnerable consumers, including persons facing foreclosure or considering a subprime mortgage; (3) establish a public database of residential foreclosures; and (4) encourage potential homeowners to obtain an independent home inspection. The OHC is further empowered to carry out any function regarding "abusive, deceptive, or unscrupulous lending practices relating to residential mortgage loans" that the Secretary of HUD finds appropriate. Finally, the subtitle requires HUD to study the root causes of default and foreclosure of home loans, including the role of escrow accounts in helping mortgage borrowers avoid default. A preliminary report of this study is due 12 months after enactment of the Act and a final report, including recommended legislation and best practices, is due 24 months after enactment.

5. Subtitle E: Mortgage Servicing

Subtitle E regulates mortgage servicing. It generally requires creditors of most first-lien, non-reverse mortgages to establish an escrow or impound account for the payment of taxes, hazard insurance, and other applicable insurance. Consumers who choose to waive this requirement must receive disclosures detailing the consequences and fees associated with that decision. Subtitle E also amends the Real Estate Settlement Procedures Act to prohibit servicers from engaging in certain practices, such as obtaining and charging for force-placed hazard insurance without first verifying that the borrower has not obtained hazard insurance, failing to take timely action in response to borrower requests, or charging fees for certain borrower requests as will be identified by the Bureau.

6. Subtitle F: Appraisal Activities

Subtitle F requires creditors to obtain an independent property appraisal before extending "higher-risk" mortgages, defined as non-qualified mortgages exceeding certain interest rate thresholds. Creditors must obtain a written property appraisal conducted by an independent, licensed appraiser and provide the higher-risk mortgage applicant with a free copy of the appraisal at least three days before closing. Appraisals generally must include a physical inspection of the interior of the property. Subtitle F identifies several creditor practices that "violate appraisal independence," such as encouraging a target appraisal value or mischaracterizing the property's appraised value, or other activities to be defined by regulation. The subtitle also grants additional powers to the Appraisal Subcommittee of the Federal Financial Institutions Examination Council ("FFIEC"), including the ability to monitor state requirements for certification and licensing of persons qualified to perform appraisals, and permits the Bureau, jointly with other federal agencies, to establish minimum requirements and quality control standards for state registration of defined "appraisal management companies."

7. Subtitle G: Mortgage Resolution and Modification

Subtitle G directs HUD to develop a program to protect tenants of "multifamily properties," or residential structures with at least five dwelling units. The program may include creating sustainable financing of such properties, maintaining existing federal, state, and local subsidies, providing funds for rehabilitation, and facilitating the transfer of multifamily properties to new owners. Also, the subtitle requires publication of certain data collected by HUD as part of the 2008 Home Affordable Modification Program of the Making Home Affordable initiative, and it requires mortgage servicers participating in the program to give a

borrower certain net present value data if the servicer denies the borrower's request for mortgage modification under such Program.

8. Subtitle H: Miscellaneous Provisions

Subtitle H establishes a $1 billion Emergency Homeowners' Relief Fund, which will operate under the 1975 Emergency Housing Act, to extend loans of up to $50,000 to homeowners who have lost their jobs, if there is a "reasonable prospect" that the homeowner can resume mortgage payments. The subtitle authorizes an additional $1 billion for HUD to distribute to state and local governments for the redevelopment of abandoned and foreclosed homes and directs HUD to establish a program for making competitive grants to organizations that provide foreclosure-related legal assistance to low and moderate-income homeowners and renters. The subtitle also requires the GAO to study inter-agency efforts to combat mortgage foreclosure rescue scams and loan modification fraud, though it provides no deadline for this study.

Finally, Subtitle H also expresses the "sense of Congress," first included in the May 2009 Mortgage Reform Act, that efforts to enhance the protection, limitations, and regulation of residential mortgage credit would be incomplete without meaningful structural reforms of Fannie Mae and Freddie Mac. Nevertheless, while documenting the major role played by these "government-sponsored enterprises" in the growth of the subprime mortgage market and the $5.3 trillion risk to taxpayers from the conservatorship of such entities, the subtitle (and indeed Title XIV as a whole) does not address their status.

9. Rulemaking and Effectiveness

All regulations required by Title X must be issued in final form within 18 months after the date designated for the transfer of functions to the Bureau under Title X (the "Transfer Date"), (s*ee* discussion of Title X, Subtitle F, above), and they must take effect within 12 months of being issued in final form. Each section of Title X becomes effective on the date its implementing regulations take effect, or 18 months after the Transfer Date if no such regulations are issued.

O. Title XV: Miscellaneous Provisions

This title contains a number of miscellaneous provisions including, among other things, a provision restricting the use of US funds for foreign governments whose public debt exceeds their gross domestic product and which are unlikely to repay their loans. Under this provision, the Secretary of the Treasury is directed to instruct the US Executive Director of the IMF to vote against any IMF loan to a middle-income country that the Executive Director determines is unlikely to be repaid.

Persons who file with the SEC and use minerals originating in the Democratic Republic of the Congo are required to make public disclosure reports to the SEC which discuss any due diligence measures undertaken to avoid involvement in illicit minerals trading in the region. Additionally, the State Department is instructed to submit to Congress a map illustrating linkages between minerals and armed groups, as well as a strategy to address the illicit minerals trade in the region.

The title requires mining companies to disclose information about safety violations in their periodic SEC filings. It also requires public disclosure to the SEC of payments related to the commercial development of oil, natural gas, and minerals which are made to the US or a foreign government. The SEC is directed to issue rules requiring such disclosures. To the extent possible, the rules will be consistent with US policy promoting transparency in these industries.

Also included in Title XV is an instruction to the GAO to complete a study within one year of enactment comparing the Presidentially-appointed inspectors general with agency-appointed inspectors general based on their relative effectiveness, independence, and expertise. The study must assess how having inspectors general of certain federal entities appointed by an entity's board or commission instead of by the head of that entity affects their independence.

Finally, this title directs the FDIC to study how revising the definition of core deposits and brokered deposits would affect the Deposit Insurance Fund. The study must discuss the differences between core and brokered deposits, their respective roles in the economy and the banking sector, and the potential for redefinition of core deposits to stimulate the economy or improve competitiveness between large institutions and community banks.

P. Title XVI: Section 1256 Contracts

The final title of the Act contains a single provision that seeks to ensure that certain swaps that will be required to be exchange-traded, such as interest rate swaps, currency swaps, basis swaps, interest rate caps, interest rate floors, commodity swaps, equity swaps, equity index swaps, credit default swaps or “similar agreements” will not be treated as Section 1256 contracts under the Internal Revenue Code. The provision also excludes from Section 1256 any securities futures contract or option on such a contract unless it is a dealer securities futures contract. Section 1256 requires that certain exchange-traded futures and options contracts are marked to market at the end of each tax year, such that their gains/losses are realized each year.

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