



Summary of the Restoring American Financial Stability Act, Passed by the Senate on May 20, 2010

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On May 20, 2010, the Senate passed the Restoring American Financial Stability Act of 2010 (the “Senate bill” or the “bill”) by a vote of 59 to 39. Four Republicans voted with the Democrats in support of the bill, and two Democrats voted against it. The Senate and the House of Representatives are expected to begin a conference shortly to resolve the differences between the Senate bill and the bill passed by the House on December 11, 2009, as described in this [Davis Polk memorandum](#). They reportedly aim to present a final bill to the President before the July 4 weekend.

Full copies of the Senate bill are not yet available, and this summary was prepared on the basis of the best available information.

Contents

Institutional Arrangements1

Systemic Regulation.....3

Bank Holding Company Act Amendments9

Resolution (Orderly Liquidation) Authority14

Emergency Financial Stabilization Powers20

Federal Reserve Governance.....21

Bureau of Consumer Financial Protection22

Derivatives.....26

Credit Retention Requirements32

Payment, Clearance and Settlement34

Changes in Broker-Dealer Regulation and Investor Protection.....34

Corporate Governance39

Executive Compensation40

Insurance41

Hedge Fund Registration and Adjustments to Accredited Investor Thresholds.....42

Credit Rating Agencies.....44

GSE Study48

Institutional Arrangements

- **Financial Stability Oversight Council.** Interagency Council, consisting of 9 voting members – the Treasury Secretary (the “Chairperson”) and the heads of the Fed, OCC, Bureau of Consumer Financial Protection (“Consumer Bureau”), SEC, FDIC, CFTC, and FHFA, and independent member with insurance expertise named by the President and confirmed by the Senate.
 - **Systemic Designations.** Council empowered to identify “systemically important” nonbank financial companies and activities, financial market utilities and payment, clearance and settlement activities. Only nonbank financial companies must be identified as systemically important to be subject to “enhanced” prudential standards, while “large, interconnected” bank holding companies (as determined by Fed?) would be subject to enhanced prudential standards without such Council determination. Although the definition of “nonbank financial company” has been narrowed in the amendment process to require a higher percentage of financial activities, Council also has the ability under certain “anti-evasion” powers discussed below to subject the financial activities of any other company to the Fed’s supervision and prudential standards applicable to nonbank financial companies.
 - **Consultation.** Council required to consult only with primary financial regulatory agencies, rather than with both the Fed and such agencies as under the House bill before designating a company as “systemically important.”
 - **Council Role in Derivatives Exemptions.** Council empowered to make determinations regarding exemptions, where necessary, to the derivatives title (Title VII). See Title VII for further detail on the Council’s role in specific exemptions proposed by other regulators.
 - **Monitoring, Reports.** Council to identify risks to financial stability, promote market discipline, and respond to emerging threats to U.S. financial markets. To serve these purposes, Council to engage in data gathering, information sharing, monitoring, and identification of gaps in regulation, among other things. Can require reports from any bank holding company or nonbank financial company supervised by the Fed to assess threats from an activity, market, or the company itself, and certified reports from systemically important companies.
 - **Fed Supervision.** Fed to supervise nonbank financial companies identified as systemically important by the Council.
- **New Office of Financial Research.**
 - **Institutional Structure**
 - **Independent Position.** The Office of Financial Research (the “Office”) is located inside of the Treasury Department, but its Director is appointed to a six-year term by the President, with advice and consent of the Senate. The Director is required to testify annually to Congress on the activities of the Office and its assessment of systemic risk, and no government officer or agency has the right to review the Director’s testimony prior to its submission. The Office has a nonvoting seat on the Council.
 - **Independent Powers.** The Office appears to have independent authority to issue regulations and collect reports, data and information without approval from the Council. It is required to make data available to the Council and Council-member agencies only as necessary to support their regulatory responsibilities.
 - **Implementing Data Standardization Rules.** The Office is required to issue regulations that standardize the scope and format of data collected by Council-member agencies on behalf of the Council, which include financial transaction data and position data. Furthermore, Council-member agencies are obligated to implement these standardization regulations—to the

extent that they do not, the Office has authority to implement these regulations with respect to the financial entities under the jurisdiction of that member agency, in consultation with the Chairperson.

- **Data Collection and Publication**
 - **Subpoena Power.** The Office's data collection efforts are backed by the power to issue a subpoena enforceable by any person or class of persons designated by the Director.
 - **The Power to "Validate" Data.** The Office has the power to "collect, validate and maintain all data."
 - **Data Publication and Confidentiality.** The Office is required to publish databases on financial companies and financial instruments. While the Office may not publish "confidential data," the term is not defined. Furthermore, FOIA applies to any data gathered by the Office.
 - **Scope of Information.** The Senate bill does not clearly define or limit the data that the Office can collect, and there is no apparent oversight of the Office's data collection. Furthermore, the bill anticipates that the Office will gather financial transaction and position data, which includes information identifying counterparties and the valuation by the financial company of a position.
 - **Requirements to Use Existing Data.** The Office is required to coordinate with financial regulatory agencies "whenever possible."
- **Risk Management Practices.** The Office is required to develop and maintain independent analytical capabilities and computing resources to promote best practices for financial risk management.
- **Assessments**
 - After an initial start-up period, the expenses of the Office and the Council will be covered by an assessment imposed on bank holding companies with total assets of \$50 billion or more and systemically important nonbank financial institutions.
- **Banking Agency Reorganization**
 - **OTS and the Thrift Charter.** Abolishes OTS and terminates the power to grant new thrift charters, unlike the House bill, which maintains the thrift charter but creates a Division of Thrift Supervision at the OCC.
 - Provides that a thrift that becomes a bank is permitted to retain its branches.
 - **Reallocation of Powers among Fed, OCC and FDIC**
 - **Fed:** Gains supervisory authority over thrift holding companies and their non-depository institution subs; rulemaking authority over thrift holding companies; and rulemaking authority over thrift transactions with affiliates, loans to insiders and tying arrangements.
 - Maintains supervisory and rulemaking authority over state member banks.
 - **OCC:** Gains supervisory authority over all federal thrifts and rulemaking authority over all thrifts.
 - **FDIC:** Gains supervisory authority over all insured state chartered thrifts.
 - **FDIC Board – Consumer Bureau takes OTS Seat.** Assigns OTS Director's seat on the FDIC board to the director of the Consumer Bureau, not the Fed Chairman as in the House bill.

- **Assessment Powers**

- The Fed is given authority to assess fees on bank and thrift holding companies with assets of \$50 billion or more and nonbank financial companies identified as systemically important, as it determines is “necessary and appropriate” to carry out its responsibilities.

Systemic Regulation

Increased Capital, Liquidity and Other Requirements

- **Applicability of Standards.** Fed required to impose “enhanced” prudential standards on “systemically important” nonbank financial companies, as well as “large, interconnected” bank holding companies.
 - To qualify as a “nonbank financial company,” a company must be “predominantly engaged in financial activities,” meaning 85% or more of the company’s consolidated annual gross revenues or consolidated total assets are attributable to activities that are financial in nature (as defined in Section 4(k) of the Bank Holding Company Act) and, if applicable, attributable to the ownership or control of one or more insured depository institutions.
 - “Nonbank financial company supervised by the Board of Governors,” the bill’s term for systemically important nonbank financial companies, is intended to apply only to nonbank financial companies which the Council has determined to be systemically important and therefore required to be supervised by the Board of Governors.
 - **2/3 Council Vote.** For nonbank financial companies, designation as systemically important requires vote of at least 2/3 of Council (including affirmative vote of the Chairperson).
 - Nonbank financial companies entitled to notice and opportunity for hearing before final determination.
 - Judicial review of designation as systemically important available, conducted under “arbitrary and capricious” standard.
 - Reevaluation of systemically important designation not less frequently than annually; rescission has same voting requirements as designation.
 - **Registration.** Once designated, systemically important nonbank financial companies must register with the Fed within 180 days. Registration is designed to collect information needed to carry out systemic regulation.
 - **Large Bank Holding Company Threshold.** Bank holding companies must have at least \$50 billion in assets for enhanced standards to apply. Fed has authority to raise – but not lower – the threshold.
 - **Financial Activities Designation for Anti-Evasion Purposes.** To prevent any domestic or foreign company from evading the provisions of the Senate bill, the Council has the power to subject any such company to the supervision of the Fed and the same enhanced prudential standards as applied to nonbanking financial companies, upon a determination by 2/3 of the Council (including the affirmative vote of the Chairperson) that:
 - material financial distress related to financial activities conducted directly or indirectly by a U.S. company, or related to the U.S. financial activities of a foreign company, would pose a threat to U.S. financial stability;
 - the company is organized or operates in such a manner as to evade application of Title I of the Senate bill; and

- the company should be subject to the Fed's supervision and such enhanced prudential standards.
- **Procedures and Consequences of Determination under Anti-Evasion Provisions**
 - The company is entitled to the same notice, opportunity for hearing and judicial review as is a nonbank financial company that has been designated as systemically important.
 - The Council must submit a report to Congress detailing the reasons for the determination.
 - Prudential standards and supervision by the Fed do not apply to the nonfinancial activities of the company.
 - Upon determination, a company may establish an intermediate holding company in which the financial activities of the company and its subsidiaries (other than internal financial activities as defined in the Senate bill) will be conducted. To facilitate supervision of the company's financial activities, the Fed may also require a company to establish an intermediate holding company that would be subject to Fed supervision and enhanced prudential standards.
 - In this context, "financial activities" are limited to activities that are financial in nature and include the ownership or control of one or more insured depository institutions, but do not include internal financial activities conducted for the company or any affiliates, including internal treasury, investment and employment benefit functions.
- **"Enhanced" Prudential Standards Include:**
 - **Required Standards.** Fed must establish stricter risk-based capital requirements, leverage limits, and liquidity requirements; require resolution plans and credit exposure reporting; and impose concentration limits.
 - **Limits on Credit Exposures to Non-Affiliates.** Concentration limits must prohibit credit exposure to any unaffiliated company that exceeds 25 percent of capital stock and surplus (or such lower amount as the Fed may prescribe by regulation).
 - **Direction to Customize Standards.** Standards to increase in stringency, to take into account differences among nonbank financial companies and bank holding companies, and to ensure to the extent possible that small changes in factors used to designate systemically important companies do not result in sharp, discontinuous changes in the standards.
 - **Minimum Leverage Capital and Risk-Based Capital Requirements.** The appropriate Federal banking agencies must establish minimum leverage and risk-based capital requirements to apply to insured depository institutions, depository institution holding companies and systemically important nonbank financial companies. The leverage capital and risk-based capital requirements must be "not less than" the "generally applicable risk-based capital requirements" and the "generally applicable leverage capital requirements," which serve as a floor, nor "quantitatively lower than" the above requirements that were in effect for insured depository institutions as of the date of enactment.
 - "Generally applicable risk-based capital requirements" and "generally applicable leverage capital requirements" mean the risk-based capital requirements and minimum ratios of tier 1 capital to average total assets, respectively, established by the appropriate Federal banking agencies to apply to insured depository institutions under the prompt corrective action regulations implementing Section 38 of the Federal Deposit Insurance Act, regardless of total consolidated asset size or foreign financial exposure.
 - The formula for "generally applicable risk-based capital requirements" must include the required ratio of regulatory capital components (numerator) over risk-weighted assets (denominator).

- The formula for “generally applicable leverage capital requirements” must include the required ratio of regulatory capital components (numerator) over average total assets (denominator).
- As drafted, the current leverage and risk-based capital requirements applicable to insured depository institutions – not those currently applicable to bank holding companies – will set the new minimum standard for leverage and risk-based capital requirements for insured depository institutions, depository institution holding companies and systemically important nonbank financial companies. Consequently:
 - Trust preferred and hybrid securities (including TARP preferred) may be included only in Tier 2 capital, whereas the Fed currently allows bank holding companies to include such securities, subject to quantitative limits and other restrictions, in Tier 1 capital. As discussed below, the absence of grandfathering and transition rules appears to be a drafting oversight.
 - Minimum leverage ratios will be 3% for institutions rated “1” (and meeting certain other conditions, such as not anticipating or experiencing significant growth) and 4% for all others for “adequately capitalized,” and 5% for “well capitalized.”
 - Minimum risk-based capital ratios will be 4% Tier 1 capital ratio for “adequately capitalized” and 6% for “well capitalized,” and 8% total capital ratio for “adequately capitalized” and 10% for “well capitalized.”
- Although the Senate bill does not provide specific grandfathering rules, we understand that grandfathering and transition rules are expected to be put in place during the conference process or that bank regulators will be instructed to do so.
- **Capital Requirements Must Address Systemic Risks.** In addition, the appropriate federal banking agencies must, subject to Council recommendations, develop capital requirements for insured depository institutions, depository institution holding companies and systemically important nonbank financial companies to address systemically risky activities. The rules must address, at a minimum, risks arising from (1) significant volumes of activity in derivatives, securitized products, financial guarantees, securities borrowing and lending, and repos; (2) concentrations in assets for which reported values are based on models; and (3) concentration in market share for any activity that would substantially disrupt financial markets if the institution were forced to unexpectedly cease the activity.
- **Discretionary Standards.** Fed may, but is not required to, establish overall risk management requirements and enhanced public disclosures.
- **Absence of Certain Statutory Mandates.** Unlike House bill, there is no mandatory leverage limit, no specific Fed authority to limit short-term debt, and no mandate to make capital requirements counter-cyclical or include off-balance sheet items in capital ratios.
- **Contingent Capital.** Fed is permitted to require contingent capital, but only after a Council study and subsequent report to Congress.
- **Risk Committees at Public Companies.** Requires risk committees for systemically important, publicly traded nonbank financial companies, as well as publicly traded bank holding companies with total consolidated assets of \$10 billion or more.
- **Stress Tests.** Requires stress tests to be conducted by the Fed but does not specify frequency.
- **Prompt Corrective Action.** Requires Fed, in consultation with the Council and FDIC, to establish requirements for early remediation of financial distress, unlike House bill, which sets forth detailed prompt corrective action standards.

- **Reports, Examinations and Enforcement Regarding Nonbank Companies.** Subjects systemically important nonbank financial companies and their subsidiaries to reporting requirements, examination by, and enforcement powers of the Fed. For depository institution and functionally regulated subsidiaries of such companies, Fed can recommend action or enforcement proceeding to primary financial regulator. If the primary financial regulator does not take action within 60 days of the Fed's recommendation, the Fed has back-up authority to take the recommended supervisory or enforcement action as if the depository institution or functionally regulated subsidiary were a bank holding company.
- **Management Interlock Prohibition.** Systemically important nonbank companies are subject to prohibition on management interlocks as if they were bank holding companies, and Fed cannot by regulation permit management interlocks between systemically important companies (other than on a temporary basis in the case of a merger, acquisition or consolidation).
- **Exemptions.** Fed, on behalf of and in consultation with Council, directed to establish criteria for exempting "types or classes" of nonbank financial companies from enhanced Fed supervision.
- **No Intermediate Holding Company Requirement.** No requirement that systemically important nonbank financial companies segregate their financial activities from their commercial activities through an intermediate holding company or comply with restrictions on transactions between the financial and commercial arms.
 - However, the Fed is granted discretion to impose such requirements and restrictions.
 - No requirement for systemically important nonbank financial companies to conform to Section 4 of the Bank Holding Company Act.

Standards and Safeguards for Systemically Important Activities and Practices

- **Designating Activities and Setting Standards.** The Council may recommend to the primary financial regulatory agencies that new or heightened prudential standards or safeguards be set for particular financial activities or practices for all bank holding companies and nonbank financial companies, whether or not institutions are individually designated as systemically important. Standards to take long-term economic growth into account and may prescribe the conduct or prohibit the activity or practice.
 - If Council rescinds its recommendation that a particular financial activity requires such standards or safeguards, each primary financial regulatory agency may choose to maintain them but must establish an appeals process for entities subject to the agency's jurisdiction.
- **Capital Requirements to Address Systemic Risks.** See "Capital Requirements Must Address Systemic Risks" on page 5.

M&A Activity

- **Bank Acquisitions.** Systemically important nonbank financial companies are subject to limits on bank acquisitions as if they were bank holding companies.
- **Large Nonbank Acquisitions.** Both bank holding companies with assets of \$50 billion or more and systemically important nonbank financial companies must obtain prior Fed approval to acquire companies with consolidated assets of \$10 billion or more engaged in financial activities made permissible by the Gramm-Leach-Bliley Act other than securities underwriting, dealing, or market-making.

Activities Restrictions, Asset Sales and Breakup Powers

- **Generally.** Requires Fed to impose restrictions on any activities or operations (e.g., proprietary trading or investing in or sponsoring hedge funds or private equity funds), or impose asset sale/breakup, if a systemically important nonbank financial company or a bank holding company with consolidated assets of \$50 billion or more is deemed to pose a “grave threat” to U.S. financial stability. Affirmative vote by 2/3 of Council members required, and other mitigation actions must be deemed inadequate, to proceed to asset sales/breakup.
 - **Compare to “Volcker Rule,”** which would impose a categorical prohibition on proprietary trading and certain fund activities by bank holding companies and their affiliates and enhanced capital and other quantitative limits on such activities by systemically important nonbank financial companies, including systemically important hedge funds.
- **Penalty for Deficient Living Will.** Asset sales can also be applied as ultimate sanction, after Fed and FDIC have imposed other requirements, if a living will that was found lacking is not resubmitted within 2 years in revised form.

“Hotel California” Provision (De-banking)

- Any bank holding company with \$50 billion or more in assets as of January 1, 2010 which received assistance or participated in the capital purchase program under TARP automatically becomes a systemically important nonbank financial company if it subsequently ceases to be a bank holding company. Appeal to the Council is possible and annual review is available.
 - **BHC Act.** Such a former bank holding company would no longer be subject to the restrictions on nonbanking activities and investments in Section 4 of the BHC Act, but it would be subject to the prior approval requirements on bank acquisitions in Section 3 of the BHC Act.
 - **Enhanced Prudential Standards.** It would continue to be subject to the enhanced prudential standards set forth above.
 - **Capital and Quantitative Limits in Volcker Rule.** It would also be subject to the portion of the Volcker Rule that requires the Fed to impose “additional” capital requirements and other quantitative limits on systemically important *nonbank* financial companies that engage in proprietary trading and investing and sponsoring hedge funds and private equity funds.
 - **Risk of Effective Ban.** Depending on how high the Fed makes the additional capital requirements or how tough it makes the additional quantitative limits, they could amount to the functional equivalent of a prohibition on the conduct of these activities even by systemically important nonbank financial companies.

Living Wills/Funeral Plans

- **Requirement.** Requires systemically important nonbank financial companies and large, interconnected bank holding companies to prepare and maintain extensive rapid and orderly resolution plans, which must be approved by the Fed and the FDIC. Imposes penalties on such firms for failing to adopt acceptable plans.
 - **Note:** the FDIC has recently proposed a rule which would require insured depository institutions with greater than \$10 billion in assets that are controlled by a holding company with greater than \$100 billion in assets to submit a living will, regardless of whether the parent company would be required to submit a living will under the Senate bill.

Systemic Regulator Fees

- **Assessments.** Unlike the House bill, establishes a Financial Research Fund that would assess systemically important companies to defray the costs of the Office of Financial Research (which include costs of the Council). Fed is also permitted to assess nonbank financial companies as it deems “necessary or appropriate” to carry out its responsibilities.

Foreign Financial Companies

- **Generally.** Both foreign financial companies that are bank holding companies or are treated as bank holding companies for purposes of the BHC Act (e.g., foreign banks with a U.S. branch, agency or commercial lending company subsidiary) and systemically important foreign nonbank financial companies may be subject to enhanced prudential standards and other provisions of the bill.
- **Anti-evasion Provision.** In addition, the U.S. financial activities of any other foreign company can be made subject to supervision and enhanced prudential standards of nonbank financial companies if the company is determined to be organized or operated in a manner that evades the application of the Act, and such financial activities in the U.S. are determined to pose a threat to U.S. financial stability.
- **Foreign Nonbank Financial Companies.** Can be designated as systemically important by the Council if substantially engaged in the U.S. in financial activities and that have substantial assets or operations in the U.S. Council to consider, among other things, the company’s U.S.-related off-balance sheet exposure, U.S. financial assets and importance as source of credit and liquidity in the U.S.
- **Application of Enhanced Prudential Standards.** In recommending and applying enhanced prudential standards to foreign companies, including foreign bank holding companies and foreign banks treated as bank holding companies, Fed must give due regard to the principle of national treatment and competitive equity.
 - **No Comparability Review.** Unlike House bill, no requirement to take into account the extent to which the parent is subject to comparable home country standards.
- **Modifications to Asset Sale/Breakup Provision, Concentration Limit.** The Fed may prescribe rules regarding applicability of asset sale/breakup provisions to foreign companies posing a grave threat, but taking into account national treatment and competitive equity. For foreign-based financial companies, the concentration limit prescribed by the Senate bill is calculated using risk-weighted assets and capital of U.S. operations.
- **Possibility for Limiting Extraterritorial Reach.** Not clear whether enhanced prudential standards or other provisions would apply only to U.S. operations of covered companies or might extend extraterritorially, but the Fed traditionally has limited U.S. regulation of foreign banks to their U.S. activities and operations. In addition, the bill provides that for foreign nonbank financial companies, references to the Fed’s authority over a “company” or its “subsidiaries” include only such company’s U.S. activities and subsidiaries, and the anti-evasion provision of the Senate bill appears to apply only to financial activities in the U.S.

Pay It Back Act

- **Changes to TARP Authorization.** Reduces TARP authorization to \$550 billion. Eliminates revolving feature of TARP authorization, except to the extent TARP funds are returned and disbursement of such funds is necessary to address an immediate and substantial threat to economy from financial instability.

- **Deficit Reduction.** Requires proceeds from sale of Fannie, Freddie and FHLB debt purchased under Treasury's emergency authority and unused funds under the American Recovery and Reinvestment Act to be used solely for deficit reduction.

Bank Holding Company Act Amendments

Volcker Rule

- **Activities Restrictions**
 - **Covered Companies.** Prohibitions would apply to insured depository institutions, their holding companies, any company treated as a bank holding company for purposes of the BHC Act (e.g., a foreign bank within a U.S. commercial banking presence) and any of their subsidiaries, *including broker-dealer and fund manager subsidiaries.*
 - **Prohibition on Proprietary Trading and Investing in or Sponsoring Certain Private Funds.** Unless excused by Council, appropriate Federal banking agencies are required to issue rules prohibiting certain companies from engaging in proprietary trading or investing in or sponsoring hedge funds or private equity funds.
 - **Ban on Proprietary Trading**
 - **Definition of Proprietary Trading.** Basic definition of proprietary trading is purchasing or selling, or otherwise acquiring or disposing of, stocks, bonds, options, commodities, derivatives, or other financial instruments for the trading book of the company "or such other portfolio as the Federal banking agencies may determine."
 - **Exemptions from Ban on Proprietary Trading.** Includes exemptions for:
 - **Customer Related Trading.** Trading "on behalf of a customer, as part of market making activities, or otherwise in connection with or in facilitation of customer relationships, including [related] risk-mitigating hedging activities." This exemption is "subject to such restrictions as the Federal banking agencies may determine."
 - **Government Obligations.** Trading in obligations issued or guaranteed by the U.S. government or its agencies, certain GSE securities, and state and municipal obligations.
 - **Foreign Trading by Foreign Companies.** Trading by a foreign company pursuant to Sections 4(c)(9) or 4(c)(13) of the Bank Holding Company Act "solely outside the United States," provided the company is not controlled by a U.S. domestic parent.
 - **No Exemptions for Trading in Certain Bank-Eligible Instruments.** No exemption for proprietary trading in other bank-eligible instruments such as over-the-counter or exchange-traded contracts for foreign exchange, interest rates or bullion.
 - **Ban on Investing in or Sponsoring Certain Private Funds**
 - **Definition of Sponsoring.** Defined as serving as a general partner, managing member or trustee of a fund; selecting or controlling a majority of the directors, trustees or management of the fund; or sharing the same name or a variation of the same name with a fund.
 - **Exemption from Ban on Investing in or Sponsoring Certain Private Funds.** An investment or activity conducted by a foreign company pursuant to Sections 4(c)(9) or 4(c)(13) of BHC Act "solely outside the United States," provided the company is not controlled by a U.S. domestic parent.
 - **No Exemption for Customer-Driven Fund Activity.** No exemption for investing in or sponsoring hedge funds or private equity funds where the covered company shows that

such activities are in connection with or in facilitation of customer relationships or designed to serve the needs of customers.

- **No General Exemptive Authority.** Agencies would not have any general authority to grant exemptions from the prohibitions, such as making distinctions between proprietary trading in other highly liquid financial instruments in contrast to illiquid and opaque instruments, or investing in or sponsoring hedge funds or private equity funds that are in connection with or in facilitation of customer relationships or otherwise to serve customer needs.
- **Disparity of Rules Applying to Foreign and U.S. Firms.** The Volcker Rule would treat foreign bank holding companies differently than their U.S. counterparts, permitting foreign bank holding companies to engage in proprietary trading and investing and sponsoring hedge funds and private equity funds off-shore. Foreign nonbank financial companies that do not have systemically important operations in the United States and are not otherwise treated as bank holding companies could conduct such activities inside the United States without being subject to the additional capital requirements or other quantitative limits.
- **Council Study.** Council required to complete a study of the activities limits of the Volcker Rule within 6 months of its enactment and make recommendations regarding their implementation, including any “modifications” to their definitions, prohibitions, requirements, and limitations that would “more effectively implement the purposes” of the activities limits. Study should include a variety of considerations.
 - **Council Study – Little More Than Window Dressing.** Volcker Rule activity limits appear inevitable despite Council study requirement. Council is not given authority to reject basic elements of Volcker Rule activity limits. Its authority is limited to “modifications” that would “more effectively implement the purposes” of the activity limits of the Volcker Rule, and the Supreme Court has previously interpreted the word “modify” to be limited to “moderate change.”
- **Rulemaking.** The appropriate Federal banking agencies would be required to issue final rules implementing the activity limits of the Volcker Rule in light of the Council’s recommendations within 9 months after the completion of the study.
- **Limitations on Transactions with “Advised” Private Funds.** Outright ban on Section 23A “covered transactions” between a covered company and private equity or hedge funds advised by a covered company. Other transactions between such companies and funds subject to Section 23B “market terms” requirements as if covered company were “member bank” and fund were its “affiliate.”
- **Capital and Quantitative Limits on Nonbank Financial Companies.** Fed required to impose additional capital requirements and quantitative limits on systemically important nonbank financial companies, presumably including systemically important hedge funds, that engage in proprietary trading or investing in or sponsoring private equity or hedge funds.
 - Depending on how those additional requirements and limits are defined, they could amount to an effective prohibition on these activities by making them too costly.
- **Transition Period.** Covered companies have 2 years from the date of final regulations to conform their activities to the Volcker Rule, subject to up to three 1-year extensions at the discretion of any such company’s appropriate Federal banking agency upon a determination that an extension would not be detrimental to the public interest.
- **Concentration Limits**
 - **Liability Cap.** Prohibits any “financial company” from merging with or acquiring substantially all of the assets or control of another company if the resulting company’s total consolidated liabilities

would exceed 10 percent of the aggregate consolidated liabilities of all financial companies at the end of the prior calendar year. Provides an exception for acquisitions where the target bank is in default or in danger of default.

- **Council Study.** Council required to complete a study of the concentration limits of the Volcker Rule within 6 months of its enactment and make recommendations regarding their implementation, including any “modifications” to the concentration limit that would “more effectively implement” the concentration limits.
 - **Council Study – Little More Than Window Dressing.** Volcker Rule concentration limits may be largely inevitable despite Council study requirement.
- **Rulemaking.** The appropriate Federal banking agencies would be required to issue final rules implementing the concentration limits of the Volcker Rule in light of the Council's recommendations within 9 months after the completion of the study.

Heightened Capital and Leverage Requirements

- Requires the appropriate Federal banking agencies to establish minimum leverage and risk-based capital requirements to apply to insured depository institutions, depository institution holding companies and systemically important nonbank financial companies. The leverage capital and risk-based capital requirements must be “not less than” the “generally applicable risk-based capital requirements” and the “generally applicable leverage capital requirements,” which serve as a floor, nor “quantitatively lower than” the above requirements that were in effect for insured depository institutions as of the date of enactment. See [“Systemic Regulation—Increased Capital, Liquidity and Other Requirements—Minimum Leverage Capital and Risk-Based Capital Requirements”](#).

Regulation of Bank Holding Companies

- **Increased Regulation of Functionally Regulated Subsidiaries of Bank Holding Companies.** Removes provisions restricting the ability of the appropriate bank regulator to examine functionally regulated subsidiaries of bank holding companies and to take enforcement action against such subsidiaries.
- **Back-Up Enforcement Authority Against Non-Depository Subsidiaries.** Requires the “lead Federal banking agency” of a depository institution holding company (*i.e.*, the FDIC or the OCC) to examine the bank permissible activities of each non-depository institution subsidiary that is not a functionally regulated subsidiary to determine whether the activities present safety or soundness risks to the depository institution and are subject to appropriate systems for monitoring and controlling the financial, operating, and other risks of the activity and protecting the depository institution subsidiaries. The lead Federal banking agency can recommend that the Fed take enforcement action against any these non-bank subsidiaries. If the Fed does not do so within 60 days of receiving the “recommendation,” the lead Federal banking agency may take such enforcement action.
- **Holding Company Level Capital and Management Requirements.** As in House bill, financial holding companies must be well-capitalized and well-managed on a consolidated basis at the holding company level as well as at the depository institution level.
- **M&A Limits**
 - **New Financial Stability Factor.** Requires Fed to consider impact of acquisitions on U.S. financial stability in approving or disapproving proposed bank and nonbank acquisitions.

- **New Prior Approval Requirement for Large Nonbanking Acquisitions by FHCs.** Requires all financial holding companies to obtain prior Fed approval before acquiring a financial company with assets of more than \$25 billion.
- **New Capital Requirements for Interstate Bank Acquisitions.** To make an interstate bank acquisition, acquiring bank must be well capitalized and well managed, not merely adequately capitalized and adequately managed, and the resulting bank must be well capitalized and well managed upon consummation of the transaction.

Source of Strength

- Companies that directly or indirectly control an insured depository institution (*i.e.*, all depository institution holding companies, including commercial companies that own industrial banks or industrial loan companies or are grandfathered thrift holding companies) are statutorily required to serve as a source of strength for the institution.
 - **Compliance Reporting.** Companies that are subject to this requirement and are not bank or thrift holding companies may be required to submit reports under oath concerning their ability to serve as a source of strength and to comply with the source of strength requirement.

Study and Related Moratorium on Bank Holding Company “Bank” Exemptions

- **GAO Study.** Calls for GAO study on whether it would be appropriate to continue Bank Holding Company Act exemptions for holding companies of credit card banks, trust companies, industrial banks or industrial loan companies; thrift holding companies that control certain limited banks; and certain trust companies and certain mutual savings banks that have a single bank subsidiary in the same state.
- **Related Moratorium on Deposit Insurance.** Imposes a moratorium on the FDIC's approval of deposit insurance applications by new industrial banks, industrial loan companies, credit card banks and trust companies that would be controlled by a commercial firm.
- **Related Restriction on Change in Control Transactions.** Requires the appropriate federal banking agency to disapprove any change in control notices by commercial companies seeking control of industrial banks, industrial loan companies, credit card banks or trust companies unless the change results from the merger or whole acquisition of the commercial company parent of the depository institution or the acquired institution is in danger of default.

Regulation of Banks

- **No Conversions When Formal or Informal Supervisory Action is Pending.** Prohibits conversion of a national banking association into a state bank or thrift, and vice versa, during any period in which the converting entity is subject to a cease and desist order, a memorandum of understanding, or any other enforcement action issued or entered into with respect to a significant supervisory matter.
 - A similar provision applies to the conversion of a Federal thrift to a national or state bank or thrift.
 - Similar to the House bill.
- **Broadened Lending Limits for Insured State Banks.** National bank lending limits also apply to insured state banks.
- **De Novo Interstate Branching.** Permits de novo interstate branching by national banks and insured state banks by amending the state “opt-in” election. Although not precisely the same interstate

branching rule as thrifts now enjoy, due to technical requirements in the Home Owners' Loan Act, this provision would place banks and thrifts generally on equal footing.

- Applications for out-of-state de novo branches would be approved if, under the law of the state in which the branch is to be located, a state bank chartered by such state would have been permitted to establish the branch.

Transactions with Affiliates and Insiders

- **Expansion of 23A to Derivatives and Securities Borrowing/Lending.**
 - Treats credit exposure on derivatives transactions and securities borrowing and lending transactions with affiliates as covered transactions for purposes of Section 23A of the Federal Reserve Act. Requires collateral for all covered transactions to be maintained at all times.
 - Expands the definition of "affiliate" under 23A to include an investment fund for which a covered bank is an investment adviser, without reference to being an investment adviser under the Investment Advisers Act.
 - Prospectively eliminates exceptions for transactions with financial subsidiaries under Section 23A.
 - Limits regulatory authority to grant exemptions under Sections 23A and 23B.
 - Allows Fed to determine how netting agreements may be taken into account in determining the amount of a covered transaction with an affiliate.
- **Transactions with Insiders.** Strengthens insider loan restrictions (including credit exposures on derivative transactions with insiders) and imposes limitations on asset purchases from insiders. Fed must consult with OCC and FDIC before proposing or adopting rules under the asset purchase provision.

Lending Limits

- **Inclusion of Derivatives in Lending Limits.** Treats credit exposure from derivatives, repos and securities loans as a "loan or extension of credit" when applying lending limits applicable to national banks and thrifts. Permits liabilities to advance funds to or on behalf of a person to be included in this calculation.

FDIC Deposit Insurance Assessments Based on Assets

- Requires the FDIC to base deposit insurance assessments on an insured depository institution's total consolidated assets minus its average tangible equity, rather than on its deposit base. Permits the FDIC to reduce the assessment base for custodial banks and banker's banks.
- Repeals the provision that no institution may be denied the lowest-risk category solely because of its size.

Securities Holding Companies

- **New Regime in Lieu of Elective Investment Bank Holding Company Status.** Replaces the ability of an investment bank holding company without a bank or thrift affiliate to elect supervision by the SEC with the securities holding company regime.
- **Purpose.** Permits a securities holding company that is required by a foreign regulator to be subject to comprehensive consolidated supervision to register with the Fed to become a "supervised securities holding company."

- **Eligibility.** Available for "securities holding companies," *i.e.* firms that own or control a SEC-registered broker-dealer, but are not systemically important nonbank financial companies, are not subject to comprehensive supervision by a federal banking agency, and are not already subject to comprehensive consolidated supervision by a foreign regulator.
- **Capital and Risk Management.** Prescribes capital adequacy and other risk management standards for supervised securities holding companies, taking into account differences among types of business activities and other enumerated factors. Permits Fed to differentiate among supervised securities holding companies on an individual basis or by category.
- **Examinations and Recordkeeping.** Permits Fed to examine a supervised securities holding company and any affiliate other than a bank (for example, an uninsured national trust bank). Permits Fed to impose recordkeeping requirements.
- **Bank Holding Company Act and Federal Deposit Insurance Act.** Generally subjects supervised securities holding companies to the provisions of the Bank Holding Company Act other than the restrictions on nonbanking activities and investments in Section 4 of the Bank Holding Company Act, but including the requirement in Section 3 of the Bank Holding Company Act to obtain prior Fed approval for acquisitions of more than 5 percent of any class of voting shares of a bank or bank holding company. Applies certain provisions of Section 8 of the FDIA to supervised securities holding companies and most nonbank subsidiaries as if the Fed were such entities' appropriate federal banking agency.

Resolution (Orderly Liquidation) Authority

Orderly Liquidation Authority

- **Still Modeled on Bank Resolution Statute.** Despite the new label and certain important changes outlined below, the Senate bill's proposed orderly liquidation authority continues to be modeled largely on the resolution authority for insured depository institutions in the Federal Deposit Insurance Act similar to the House bill. The discussion below focuses on differences between the Senate bill, the House bill and the original Senate proposal.
 - **Core Resolution (Orderly Liquidation) Powers Retained.** In particular, the FDIC retains its core resolution powers to take control of the institution as receiver, to act quickly to sell all or any selected assets and liabilities to a third party (regardless of priorities among creditors and without the consent of any affected party or court approval – *i.e.*, "cherry pick") or, if a third party buyer cannot be found at fair value, to establish one or more temporary bridge financial companies to hold the part of the business worth preserving until it can be sold to one or more third parties at fair value or liquidated in an orderly fashion. Two notable differences from the bank resolution statute are as follows:
 - **Limitations on Cherry-picking Authority.** Limits the FDIC's cherry-picking power so that it cannot be exercised in order "to avoid or mitigate serious adverse effects to financial stability of the United States."
 - **Liquidation and Wind Up.** Requires the receiver to liquidate and wind up a company in resolution.
 - **Judicial Review.** Requires the Treasury Secretary to obtain an order from the U.S. District Court for the District of Columbia (rather than a special bankruptcy court panel, as originally proposed) authorizing the Treasury Secretary to appoint the FDIC as receiver.
 - **Exception for Board Consent.** This condition does not apply if the board of directors of the covered financial company consents to the appointment of the FDIC as receiver. Since the

statute also provides boards of directors with immunity from liability for breaching their fiduciary duties if they give such consent, the Treasury Secretary is likely to avoid such court review by imposing intense pressure on boards to give their consent, and boards are likely to determine that it is in their personal interests to acquiesce.

- **“Arbitrary and Capricious” Standard of Review and No Authority to Second Guess Systemic Risk Determinations.** The court’s authority would be limited to reviewing whether the Treasury Secretary’s determinations that the company is a financial company and is in “default or danger of default” (as defined) are not arbitrary or capricious (rather than that the financial distress determination alone is supported by substantial evidence, as originally proposed), and would not extend to the Treasury Secretary’s systemic risk determinations.
- **Confidential.** Proceeding would be confidential, backed up by criminal penalties for “reckless” (but not merely negligent) disclosures.
- **Expedited.** The court would be required to rule within 24 hours of receiving a petition from the Treasury Secretary, or else the petition will be deemed granted by operation of law.
- **Due Process.** Affected company would be given notice of the hearing and an opportunity to oppose the determination.
- **Appellate Review; No Stay.** Either party may appeal decision to the U.S. Court of Appeals for the D.C. Circuit and then to the U.S. Supreme Court on an expedited basis, but decision may not be stayed or enjoined pending appeal.
- **Limits on Definition of “Financial Company”.** Three limits imposed on the definition of financial company:
 - **Subsidiaries.** Only subsidiaries of a bank holding company, systemically important nonbank financial company or other company predominantly engaged in financial activities that are themselves predominantly engaged in financial activities are included within the term “financial company”. Non-financial subsidiaries are no longer included. Insured depository institution and insurance company subsidiaries are still excluded.
 - **Predominantly Engaged.** No companies can be deemed to be predominantly engaged in financial activities unless 85% or more of the company’s consolidated annual gross revenues are attributable to such activities.
 - **Excluded Companies.** GSEs, FHLBs, Farm Credit System Institutions and “government entities” are excluded from the definition of financial company. “Government entities” is not defined.
- **Imposes a Time Limit on Resolution.** Imposes a 3-year time limit on the duration of the FDIC’s role as receiver, with 2 one-year extensions.
 - **Extensions.** Such extensions are permitted only upon a written certification by the FDIC Chairperson that continuation of the receivership is necessary to maximize the net present value return or minimize the amount of loss, and to protect the stability of the financial system, and, for the second extension, a report to Congress is required.
 - **Further Litigation Extension.** Permits further extension solely for the purpose of completing ongoing litigation in which the FDIC as receiver is a party upon certain determinations by the Council and an FDIC report to Congress. In such a case, the appointment of FDIC as receiver must end within 90 days after the completion of the litigation.
 - **No Liability after Expiration of Receivership.** Provides that neither the FDIC nor the Deposit Insurance Fund will be liable for unresolved claims arising from the receivership after the termination of the receivership.

- **Reducing Gap with Bankruptcy Code.** Reduces the gap between the rules defining creditors' rights under the Bankruptcy Code and the new orderly liquidation authority, although does not close the gap altogether. Changes include:
 - **Preferential or Fraudulent Transfers.** Legally enforceable or perfected security interests and other transfers of property would no longer be avoidable if "taken in contemplation of the company's insolvency" as under the bank resolution provisions in the Federal Deposit Insurance Act. Instead, they would be avoidable only if they amounted to preferential or fraudulent transfers under the Bankruptcy Code.
 - **Special Enforceability Requirements.** Although agreements against the interest of the receiver or a bridge financial company would still have to be in writing and meet certain other special enforceability requirements to be enforceable against them as required by the bank resolution statute (but not the Bankruptcy Code), any written agreement that was duly executed or confirmed in the ordinary course of business that the counterparty could prove to the satisfaction of the receiver would be enforceable (closer to Bankruptcy Code).
 - **Contingent Claims.** Contingent claims in the form of guarantees, letters of credit, lines of credit and other similar claims would be recognized as provable claims equal to their estimated value as of the date of the receiver's appointment, which would be estimated in a manner similar to how they are estimated under the Bankruptcy Code if the FDIC so prescribes by rule or regulation.
 - **Security Interest and Security Entitlements.** Legally enforceable or perfected security interests and legally enforceable security entitlements in respect of assets held by the covered financial company would be respected as property rights.
 - **Damages for a Repudiated Debt Obligation.** Would be calculated as the face amount of the obligation plus accrued interest and accreted original issue discount, determined as of the date of the receiver's appointment.
 - **Limited Right to "Post-Appointment" Interest.** Similar to "post-petition" interest provisions of the Bankruptcy Code, for a secured claim, any accrued interest would be calculated through the date of repudiation, to the extent that such allowed secured claim is secured by property the value of which is greater than the amount of such claim.
 - **Setoff Rights.** Setoff rights respected as under the Bankruptcy Code, with some qualifications to permit receiver to transfer liabilities to third party or bridge financial company even if the transfer destroys the mutuality of offsetting claims.
 - **Choice of Law Rules.** Noninsolvency choice of law rules would determine applicable noninsolvency law governing the perfection of security interests and the creation and enforcement of security entitlements.
 - **Additional Due Process.** Narrows the gap between the due process protections of the Bankruptcy Code and those provided under the bank resolution statute on which this orderly liquidation authority is modeled, including gatekeeping role of the D.C. district court, additional opportunity for judicial review of the claims process and certain notice and hearing rights.
 - **Minimum Recovery Right.** To ensure minimum due process, all creditors would be entitled to receive at least what they would have received in a liquidation of the covered financial company under Chapter 7 of the Bankruptcy Code.
 - **Mandatory Rulemaking.** The FDIC would be required to promulgate rules to implement the orderly liquidation authority in a manner that increases legal certainty and further reduces the gap between how creditors are treated in a liquidation under the Bankruptcy Code and how they are treated under the orderly liquidation authority.

- **Claims determination.** Requires the receiver to determine claims in accordance with the requirements of Section 210(a) and the FDIC's regulations.
- **Liquidation of “Stockbrokers” and “Commodity Brokers.”** The FDIC, as receiver, would be required to apply applicable liquidation provisions of the Bankruptcy Code in liquidating “stockbrokers” that are not members of SIPC and “commodity brokers” (as such terms are defined in subchapters III and IV, respectively, of chapter 7 of the Bankruptcy Code.)
- **Covering Broker-Dealers and Protecting Customer Property.** Clarifying that the new resolution authority would apply to *broker-dealers that are members of SIPC* and attempting to create a framework for providing the same protection for customer property as would be provided in a normal SIPC proceeding under SIPA. ***Although it is far from clear that the proposed new customer protection rules work as a technical matter***, the following summarizes how we believe the new proposal was intended to work:
 - The FDIC would appoint SIPC to act as trustee for the liquidation of a covered broker-dealer.
 - Liquidation of the covered broker-dealer would follow normal SIPC processes, with the same customer protection priorities.
 - However, qualified financial contracts would be governed by special provisions that supersede the Bankruptcy Code and SIPC practices.
 - Concurrent with the FDIC-appointed SIPC liquidation, the FDIC could create a “bridge financial company” and transfer any assets and liabilities, including any customer accounts, customer name securities and customer property, to the bridge financial company from the covered broker-dealer.
 - Despite this transfer, SIPC would be required to satisfy remaining customer claims “in the same manner and amount” as if the FDIC was not involved in the liquidation.
 - The bridge financial company would be deemed registered with the SEC and SROs and could operate as a broker-dealer subject to compliance with the securities laws. It is not clear how the broker-dealer capital rules and mechanics of operation such as clearing arrangements would apply to the bridge broker-dealer.
- **Orderly Liquidation Fund Not Pre-Funded.** Unlike the original Senate proposal or the House bill, the Senate bill would not pre-fund the orderly liquidation fund established in Treasury.
 - **Resolution Costs Funded by Borrowings from Treasury.** The FDIC would have the authority to fund the costs of resolving any particular covered financial company by issuing debt securities to Treasury, up to a maximum amount for each covered financial company equal to:
 - during the 30-day period immediately following the appointment of the receiver, 10% of the *book value* of the covered financial company’s total consolidated assets (based on its most recent financial statements available), and
 - after such 30-day period, 90% of the *fair value* of such company’s total consolidated assets that are available for repayment.
 - **Post-Event Assessments to Repay Borrowings from Treasury.** The FDIC would be required to repay its borrowings from Treasury within 60 months by, if necessary, imposing assessments:
 - **Claimants that Received Excess Benefits.** “As soon as practicable” on any “claimant that received additional payments or amounts from the [FDIC] pursuant to subsection (b)(4), (d)(4) or (h)(5)(E), except for payments or amounts necessary to initiate and continue operations essential to implementation of the receivership or any bridge financial company, to recover on a cumulative basis” any excess benefits that such claimant received in the receivership over

what such claimant was entitled to receive in a liquidation under Title II (i.e., what the claimant would have received in a liquidation under Chapter 7 of the Bankruptcy Code or in a SIPC proceeding).

- **Large Financial Companies.** If the amounts to be recovered on a cumulative basis from such claimants are insufficient to allow the FDIC to repay its obligations to Treasury within 60 months, the FDIC would be required to recover the shortfall from assessments on eligible financial companies and other financial companies with total consolidated assets of \$50 billion or more.
- **Eligible Financial Companies.** Any bank holding company with total assets of \$50 billion or more and any nonbank financial company designated as systemically important by the Council.
- **Graduated Assessments Based on Assets, Risks and Other Factors.** The FDIC is required to impose higher rates based on risk and size of assets (i.e., the higher the risk and higher the assets, the higher the assessment rates). The FDIC must take the following factors into account in determining the size of assessments:
 - **General Conditions.** Economic conditions generally at the time;
 - **Other Guarantee Arrangements.** Any assessments imposed pursuant to other laws on an eligible financial company's insured depository institution subsidiaries to fund deposit insurance, on broker-dealer subsidiaries to fund SIPC insurance or on the eligible financial company (if an insurance company) or an insurance company subsidiary for a state insurance guarantee fund;
 - **Financial Condition.** Financial condition of the company;
 - **Risk to the System.** Risk presented by the financial company to U.S. financial stability;
 - **Beneficiary of Orderly Liquidation.** The extent to which the company received benefitted, or likely would benefit, from the orderly liquidation of a covered financial company (compared, for example, to a liquidation under Chapter 7 of the Bankruptcy Code); and
 - **Other Factors.** Other factors that the FDIC deems appropriate.
- **Rulemaking.** The FDIC would be required, in consultation with the Treasury Secretary, to issue rules and regulations to govern the assessment process.
- **Acceptable Orderly Liquidation Plan.** The FDIC may not use any of the funding as receiver for any covered financial company unless and until it shall have submitted an orderly liquidation plan for such company that is acceptable to the Treasury Secretary.
- **Other Important Differences from the House Bill (and, Where Noted, the Original Senate Proposal):**
 - **QFCs.** Automatic stay would be three business days (compared to one in the House bill and five in the prior draft of the Senate bill).
 - **Guaranteed Subsidiary Contracts.** FDIC would have the power to enforce subsidiary contracts (including QFCs) that are guaranteed by a covered financial company in receivership notwithstanding any cross-default in the underlying contract based solely on the insolvency of the guarantor, if the guarantee and all related assets/liabilities are transferred to a bridge financial company or a third party.

- **Clearing Organization.** The receiver would be required to use its best efforts to meet all margin, collateral and settlement obligations of a covered financial company with a clearing organization with respect to QFCs; if the receiver defaults on such obligations, the clearing organization would have the right to exercise its rights and remedies immediately with respect to such QFCs despite any otherwise applicable stay on the exercise of close-out or other rights.
 - **No Haircuts on Secured Credit.** No Miller-Moore language regarding haircuts on secured creditors.
 - **Prohibition on Taxpayer Funding of Bailouts.** Prohibits taxpayer funds from being used to prevent liquidation of a firm. All funds expended should be recovered either through disposition of assets of a covered financial company or assessments on the financial sector, to ensure no taxpayer losses.
 - **Directors and Officers.**
 - **Personal Liability.** As in the House bill, Directors and officers of a covered financial company may be held personally liable for monetary damages in any civil actions by the FDIC with respect to gross negligence or a greater disregard of a duty of care under applicable state law. Federal courts are required to expedite the consideration of any case brought by the FDIC against directors and officers of a covered financial company.
 - **Recoupment of Compensation from Senior Executives and Directors.** The FDIC is permitted to recover from any current or former senior executive or director substantially responsible for the failed condition of a covered financial company any compensation received during the 2 year period prior to the date the FDIC is appointed as receiver. In the case of fraud, no time limit will apply. In seeking to recover any such compensation, the FDIC is required to weigh the financial and deterrent benefits of such recovery against the cost of executing the recovery.
 - **Ban on Senior Executives and Directors.** Permits the Federal Reserve, or if the covered financial company was not supervised by the Federal Reserve, the FDIC, to prohibit a senior executive or director of a covered financial company from participating in the conduct of the affairs of **any** financial company for a period of time of not less than 2 years if the Federal Reserve or FDIC determines that the senior executive or director:
 - violated any law, regulation, final cease-and-desist order, written condition in an application, notice or request, or written agreement;
 - engaged or participated in an unsafe or unsound practice in connection with any financial company; or
 - committed or engaged in any act, omission, or practice which constitutes a breach of the fiduciary duty of such executive or director;
- and
- by reason of such violation, practice or breach received financial gain or other benefit and such violation, practice or breach contributed to the failure of the company; and
 - such violation, practice or breach involves personal dishonesty or demonstrates a willful or “continuing” disregard for the safety and soundness of such company.
- **Insurance Companies.** Insurance companies are liquidated or rehabilitated under applicable state law. FDIC has back up authority if the appropriate regulatory agency has not filed an appropriate judicial action in State court within 60 days of the determination by the U.S. District Court for the District of Columbia.

■ **Monitoring and Studies**

- **Inspector General Reviews.** Provides the Inspector General of the FDIC, Treasury Inspector General, and the Inspector General of primary financial regulatory agencies with authority to conduct, supervise, and coordinate audits and investigations in connection with the liquidation of a covered financial corporation.
- **Report to Congress and the Public.** No later than 60 days after appointment of the FDIC as receiver, the FDIC is required to file a report with Congress setting forth enumerated information, including information on the company's financial condition, description of the plan to wind down the covered company and expected costs of the liquidation.
- **Report on Judicial and Bankruptcy Processes.** Requires the GAO and Administrative Office of the United States Courts to monitor the activities of the U.S. District Court for the District of Columbia and conduct separate studies on the bankruptcy and orderly liquidation process for financial companies under the Bankruptcy Code.
- **Report on International Coordination.** Requires GAO study on international coordination of orderly liquidation of financial companies.
- **Report on Implementation of Prompt Corrective Action Measures.** Requires GAO study of the prompt corrective action implementation by federal banking agencies and report to Congress within 1 year after the date of enactment. The Council is required to submit a report to Congress within 6 months on actions taken in response to the report.

Emergency Financial Stabilization Powers

Modifications to 13(3) Emergency Secured Liquidity Powers

- **Limits Power to Market-Wide Programs.** Limits Section 13(3) assistance to a "program or facility with broad-based eligibility," but not to any single individual, partnership or corporation.
- **Policies and Procedures.** Fed must establish by regulation, in consultation with the Treasury Secretary, policies and procedures governing emergency lending designed to ensure that any emergency lending program or facility is designed to provide liquidity to the financial system and not to aid a failing financial company; that collateral for emergency loans is sufficient to protect taxpayers from losses and that any such program is terminated in a timely and orderly fashion.
 - The policies and procedures must require that a Federal Reserve Bank assign a lendable value to all collateral for any loan executed by such a Federal Reserve Bank under amended Section 13(3) to determine whether the loan is secured satisfactorily.
 - Fed must also establish procedures to prohibit borrowing from programs and facilities by borrowers that are insolvent.
 - No program or facility that is structured to assist a single and specific company will be deemed to be program or facility with broad-based eligibility.
- **Approval from Treasury Secretary.** The Fed is required to obtain the Treasury Secretary's approval before establishing a program or facility under Section 13(3).
- **Reporting Requirements.** Fed must provide to Congress, within 7 days, a report that justifies the exercise of authority and describes the material terms of the assistance. Upon the request of the Chairman of the Federal Reserve Board, certain information (including the identity of the participants in the program or facility) may be kept confidential. The GAO is given authority to audit any Section 13(3) facility or existing Federal Reserve credit facility.

- **Audit of the Federal Reserve.** GAO is required to commence a one-time audit of all loans or other financial assistance provided through the Fed's exercise of 13(3) authority between December 1, 2007 and the enactment of the legislation. Fed must publish, on its website, the receipts and terms of 13(3) assistance provided.
 - Within 12 months after the enactment of the legislation, the GAO must also complete an audit of the governance of the Federal Reserve Bank system.

Emergency Financial Stabilization

- **Eliminates the FDIC's Open Bank Assistance.** Limits the FDIC's authority to provide assistance to individual banks upon a systemic risk finding to only those banks that have been placed in receivership and only for the purpose of winding up the institution. Requires the Treasury Secretary to report to Congress on the systemic risk finding within 3 days.
- **Liability Guarantee Programs.** Provides that the FDIC can create a widely available program to guarantee obligations of solvent depository institutions, depository institution holding companies and affiliates during times of severe economic distress. This authority would replace Section 13(c)(4)(G)(i) of the FDIA as the source of authority for widely available guarantee programs.
- **Policies and Procedures.** FDIC must establish by regulation, in consultation with the Treasury Secretary, policies and procedures governing issuance of such guarantees. Terms and conditions of any guarantee program must be established by the FDIC with the concurrence of the Treasury Secretary. Establishment of a guarantee program requires finding by 2/3 of the FDIC and Fed that there has been a liquidity event and that a failure to take action would have serious adverse effects on financial stability or economic conditions in the U.S, as well as a joint resolution of Congressional approval of the maximum amount of debt that can be guaranteed.
 - Liquidity event means either (i) an exceptional and broad reduction in the general ability of financial market participants either to sell financial assets without an unusual and significant discount or borrow using financial assets as collateral without an unusual and significant increase in margin or (ii) an unusual and significant reduction in the ability of financial market participants to obtain unsecured credit.
- **No Equity Investments.** The guarantee may not include the provision of equity in any form.
- **Borrowing Power and Costs.** FDIC can borrow from the Treasury but must charge fees and other assessments to participants in such amounts as are necessary to offset projected losses and administrative expenses.

International Sovereign Assistance

- Amends Bretton Woods Agreements Act to require the President to direct the United States Executive Director of the International Monetary Fund to evaluate any proposed loan to a country by the Fund if the amount of the public debt of the country exceeds the gross domestic product of the country and determine whether or not the loan will be repaid and certify that determination to Congress. If the Executive Director determines that a loan by the International Monetary Fund to a country will not be repaid, the President is required to direct the Executive Director to vote in opposition to the proposed loan.

Federal Reserve Governance

- **New Senate Confirmation Requirement for President of New York Fed.** The President of the Federal Reserve Bank of New York to be appointed by the President with the advice and consent of the Senate.

- **Change in Procedures for Electing FRB Directors.** No company, or subsidiary or affiliate of a company, that is supervised by the Fed may vote for members of the board of directors of a Federal Reserve Bank. No past or current officer, director or employee of such company, or subsidiary or affiliate of such company, may serve as a member of the board of directors of a Federal Reserve bank.
- **New Fed Board Vice Chairman of Supervision.** Creates position of Vice Chairman of Supervision on the Federal Reserve Board, with such individual to be designated by the President by and with the advice and consent of the Senate and to report semi-annually to Congress. The Vice Chairman is to oversee the supervision and regulation of firms under the Fed's supervisory jurisdiction and make policy recommendations for the Fed with respect to such firms.
- **New Express Systemic Risk Duties.** Identification and mitigation of risks to financial stability added as a responsibility of the Federal Reserve Board.

Bureau of Consumer Financial Protection

- **Scope of Authority.** As in the House bill, Consumer Bureau would have very broad powers to regulate and enforce substantive standards for any person engaged in offering or selling a "consumer financial product or service" other than those explicitly carved out from the Consumer Bureau's authority.
- **Not a Stand-Alone Agency.** Consumer Bureau is established within the Federal Reserve System, but the Director is appointed by the President, by and with the advice and consent of the Senate. Fed is forbidden from intervening in Consumer Bureau examinations or enforcement actions or delaying or preventing the issuance of any Consumer Bureau rule or order.
- **Checks on Consumer Bureau's Rulemaking Authority.**
 - **Council Stay and Veto Power.** Chairman of the Council may temporarily stay the effectiveness of a Consumer Bureau regulation if petitioned to do so by a member agency, and upon a 2/3 vote of its members the Council may permanently set aside a Consumer Bureau regulation.
 - **Written Objection of Prudential Regulator.** If a prudential regulator objects in writing to a proposed Consumer Bureau rule, the Consumer Bureau must include the objection in the rule's adopting release and explain the Consumer Bureau's decision regarding the objection.
 - **Consumer Bureau/SEC Rulemaking Cooperation.** Requires SEC and Consumer Bureau coordination of rulemaking only where "feasible." Requires the SEC to develop procedures for providing advance notice to the Consumer Bureau when the SEC is initiating such a rulemaking.
- **Enforcement Authority over "Very Large" Insured Depository Institutions.** Consumer Bureau has primary enforcement authority with respect to any insured depository institution with total assets of \$10 billion or more **and any affiliate thereof** (except those affiliates explicitly carved out of the Consumer Bureau's authority, such as broker-dealers and insurance companies). Smaller insured depository institutions will be subject to the exclusive enforcement authority of their prudential regulators.
- **Enforcement Authority over Nondepository Covered Persons.** Consumer Bureau has primary enforcement authority with respect to nondepository covered persons to the extent that they (i) offer, provide or service consumer real estate loans, or provide loan modification or foreclosure relief services in connection with such loans; or (ii) are "larger participants" of a market for other consumer financial products or services as defined by rule by the Consumer Bureau in consultation with the FTC.

- **Extent of Regulated Entity Carve-Out from Authority of Consumer Bureau of Consumer Financial Protection.**
 - Among other regulated entities excluded from the Consumer Bureau's authority:
 - SEC-regulated persons, including any person required to be registered with the SEC under the Securities Exchange Act of 1934, including: broker-dealers, registered investment advisers, registered investment companies, companies that elect to be regulated as a business development company under the Investment Company Act of 1940; self-regulatory organizations; credit rating agencies; securities information processors; and municipal securities dealers, to the extent such persons act "in a regulated capacity."
 - CFTC-regulated persons, including any person that is registered, or required by statute or regulation to be registered, with the CFTC, to the extent that the activities of such persons are subject to the jurisdiction of the CFTC.
 - Persons regulated by a state insurance regulator, including any person that is engaged in the business of insurance and subject to regulation by any State insurance regulator, to the extent that such person acts in "such capacity."
 - Language in the Senate bill appears to change the degree to which certain regulated entities are carved out from the authority of the Consumer Bureau in the House bill, but this could be merely a drafting discrepancy. For example:
 - The scope of the prohibition on the ability of the Consumer Bureau to act with respect to certain regulated entities differs:
 - House bill provides that the Consumer Bureau shall have "no rulemaking supervisory, enforcement or other authority" with respect to SEC-regulated persons.
 - Senate bill provides that the Consumer Bureau shall have "no authority to enforce this title" with respect to SEC-regulated persons.
 - The scope of the carveout for certain regulated entities' activities from the authority of the Consumer Bureau differs:
 - House bill carves out any person "regulated by" the CFTC, but only to the extent that such person "acts in a registered capacity";
 - Senate bill carves out any person "regulated by" the CFTC, but only to the extent that such person's activities are "subject to the jurisdiction of the [CFTC] under the Commodity Exchange Act."
- **Relationship to State Law.**
 - OCC and courts authorized to preempt state law "in accordance with the legal standard of the decision of the Supreme Court in *Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner, et al.*," which holds that states may regulate national banks where "doing so does not prevent or significantly interfere with" a national bank's exercise of its powers.
 - Preemption authority not granted with respect to subsidiaries or affiliates of national banks that are not national banks themselves.
 - Evidentiary burden and deference standards imported from House bill.
 - Generally, state attorneys-general may bring civil actions to enforce the consumer protection provisions of the Senate bill or regulations prescribed by the Consumer Bureau thereunder — with respect to national banks and thrifts, however, state attorneys-general may bring civil actions

only to enforce Consumer Bureau regulations, and not violations of provisions of the Senate bill itself.

- Any state regulator may bring a civil action to enforce the consumer protection provisions of the bill or regulations prescribed by the Consumer Bureau thereunder with respect to any entity (other than a national bank or thrift) that is state-chartered, incorporated, licensed or otherwise authorized to do business in the state.
- Any actions brought by state attorneys-general must be brought in a federal or state court in the attorney-general's own state.
- State attorneys-general may also bring enforcement actions against a national bank or thrift for violations of a non-preempted State law.
- Private parties are not precluded from enforcing applicable rights under Federal or State law.
- **Funding.** Consumer Bureau would not be funded by assessments on covered companies, but would receive annually from the Fed an amount equal to 10-12% of the Fed's total operating expenses.
- **Other Notable Provisions.**
 - **Community Reinvestment Act Not an "Enumerated Consumer Law."** Rulemaking and enforcement presumably will remain within the authority of the appropriate Federal banking agencies.
 - **Federal Trade Commission to Retain Authority.** FTC retains all existing authority under the Federal Trade Commission Act or any other law other than the enumerated consumer laws, with respect to which the FTC's existing rulemaking authority is transferred to the Bureau. FTC to have authority to enforce Consumer Bureau-issued regulations with respect to covered persons subject to FTC jurisdiction under the FTC Act.
 - **Definition of "Financial Product or Service" Includes Bank-Related Catch-All.** Any financial product or service permissible for a bank or for a financial holding company to offer or provide under federal law or regulation that has, or likely will have, a "material impact on consumers," as determined by the Consumer Bureau satisfies the definition.
 - **Notable Carve-outs from Definition of "Consumer Financial Product or Service":**
 - Business of insurance.
 - Extension of commercial credit to a person who originates consumer credit transactions.
 - Sale of a stored value product if the seller does not exercise "substantial control" over the terms or conditions of the stored value product, *i.e.*, the seller simply sells the product but does not establish its terms and conditions.
 - Publishing market data, news, or data analytics or investment information or recommendations that are not tailored to the individual needs of a particular consumer.
 - Collecting, analyzing, maintaining or providing consumer report information, including credit histories of consumers, that relates solely to purchase finance transactions between a consumer and such person.

- **Restrictions on Card Networks and Card Issuers.**
 - Interchange transaction fees must be “reasonable and proportional to the actual cost” of the card network’s expense for processing the transaction. Exempts card issuers with less than \$10 billion in assets.
 - Prohibits card issuers from establishing anti-competitive payment card network restrictions, including: inhibiting the ability of any person to provide a discount or in-kind incentive for the use of cash, check or another payment card; or inhibiting the ability of any person to set minimum or maximum dollar amounts for the use of card.
- **Prohibition on Steering Incentives for Mortgage Originators**
 - Prohibits an originator from receiving compensation that varies based on the terms of the loan other than the amount of the principal. Prohibits the inclusion of most loan origination fees in the interest rate charged on consumer credit transactions secured by real property except in certain limited circumstances.
- **Minimum Standards for Residential Mortgage Loans.**
 - Prohibits consumer lending secured by real property or a dwelling without a determination by the lender, based on “verified and documented information”, that the consumer has a “reasonable ability to repay” the loan and all applicable taxes, insurance and assessments. Does not apply to bridge loans of 12 months or less or to reverse mortgages
- **Authority to Restrict Mandatory Predispute Arbitration.** Consumer Bureau must conduct a study of mandatory predispute arbitration provisions before it may determine to limit their use; any such limits must be consistent with the findings of the study.
- **Disclosure Rules.** Consumer Bureau authorized to prescribe disclosure rules with respect to the features of consumer financial products or services; Consumer Bureau may issue model disclosure form, use of which establishes a disclosure compliance safe harbor.
- **Prohibition on Certain Prepayment Penalties.** Prohibits prepayment penalties on residential mortgage loans that are not “qualified mortgages,” *i.e.*, non-traditional mortgages that do not meet certain criteria, including that they be fully documented, fixed-rate and fully amortizing; also limits but does not outright prohibit prepayment penalties with respect to qualified mortgages, requiring lenders offering products containing such penalties to offer products without them.
 - Transfers from federal banking agencies to the Consumer Bureau the authority to prescribe regulations regarding revisions to the criteria that define a “qualified mortgage” in the context of the prohibition on certain types of prepayment penalties.
- **Remittance Transfers.** Imposes disclosure obligations on providers of remittance transfers, although to a less restrictive degree than in the House bill.
- **Expanded Application of Truth in Lending Act.** Amends the Truth in Lending Act to apply to credit transactions and consumer leases below \$50,000 (instead of \$25,000).
- **Consumer Information Requests.** Requires that covered persons comply with consumer requests for information concerning a consumer financial product or service obtained from the covered person, but excludes from the disclosure obligation confidential commercial information, information collected to prevent fraud or money laundering, or to detect or make a report regarding other unlawful conduct, or other nonpublic or confidential information.
- **Adverse Actions Based on Consumer Credit Reports.** Any person who takes an adverse action with respect to any consumer based in whole or in part on consumer report information must provide that consumer with his or her numerical credit score; the consumer’s current or

most recent credit score; the range of possible credit scores under the model used; up to four key factors that adversely affected the credit score of the consumer; the date on which the credit score was created; and the name of the person or entity that provided the credit score or credit file.

- Authorizes Treasury Secretary to establish multiyear grants, cooperative agreements and other programs to expand access to mainstream financial institutions and provide alternatives to Payday loans. Authorizes the Community Development Financial Institutions Fund to make grants to community development financial institutions to support small dollar loan programs.

Derivatives

▪ **Prohibition on Federal Assistance to Swap Entities**

- Prohibits the Federal government from providing “Federal assistance” to any swaps entity with respect to any swap or security-based swap or other activity of the swaps entity.
 - Defines “swaps entity” to include registered swap and security-based swap dealers, major swap participants and major security-based swap participants, swap execution facilities, designated contract markets, national securities exchanges, central counterparties, clearing houses, clearing agencies and derivatives clearing organizations.
 - Defines “Federal assistance” to include any funds, including (i) advances from any Federal Reserve credit facility, discount window or pursuant to Section 13(3) of the Federal Reserve Act; (ii) FDIC insurance; and (iii) guarantees, for the purpose of making any loan or purchasing any stock, equity interest or debt obligation of any swaps entity; purchasing the assets of any swaps entity; guaranteeing any loan or debt issuance of any swaps entity; or entering into any assistance arrangement (including tax breaks), loss sharing or profit sharing with any swaps entity.
- Would effectively require most banks to move their swaps activities into a non-bank affiliate. Otherwise, the bank would risk being a “swap dealer” or “major swap participant,”¹ thereby becoming ineligible to receive Fed and FDIC guarantees or funding.

▪ **Definition of Swap Dealer and Major Swap Participant**

- Defines major swap/security-based swap participant (“MSP”) as any non-dealer who:
 - maintains a substantial position in swaps for any of the major swap categories as determined by the Commission, excluding (i) positions held for hedging or mitigating commercial risk and (ii) positions maintained by any employee benefit plan under ERISA for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan; or
 - whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or
 - is a financial entity[, *other than an entity predominantly engaged in providing financing for the purchase of an affiliate’s merchandise or manufactured goods,*]² that is highly leveraged relative to the amount of capital it holds and maintains a substantial position in outstanding swaps in any major swap category as determined by the Commission.

¹ For ease of presentation, unless otherwise indicated references in this summary to “swap,” “swap dealer” and “major swap participant” also refer to security-based swap, security-based swap dealer and major security-based swap participant.

² The bracketed and italicized words are found in the definition of “major swap participant” but not “major security-based swap participant.”

- Requires the CFTC and the SEC to provide a definition of “substantial position” that is “prudent for the effective monitoring, management and oversight” of entities that are systemically important or can significantly impact the financial system of the United States.
- Defines “swap dealer” as any person who holds itself out as a dealer in swaps; makes a market in swaps; regularly engages in the purchase and sale of swaps in the ordinary course of business; or engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps.
 - Excludes a person that buys or sells swaps for such person’s own account, either individually or in a fiduciary capacity, but not as part of a regular business.
- Expands Commodity Exchange Act definitions of futures commission merchant, introducing broker, commodity pool and commodity pool operator.
- **Fiduciary Duty**
 - Imposes a fiduciary duty on swap dealers that provide advice regarding, offer to enter into, or enter into a swap with a government entity or agency, pension plan, endowment or retirement plan. This provision is highly controversial and has been criticized by state treasurers and financial and nonfinancial trade and industry associations.
- **Regulation of Swaps**
 - Generally retains the jurisdictional split between the CFTC and SEC that has been an element of the Dodd bill and the House bill.
 - Grants the CFTC and the SEC joint jurisdiction over “mixed swaps” that contain both swap and security-based swap components.
 - Grants the CFTC jurisdiction over foreign exchange swaps and foreign exchange forwards, unless Treasury makes a written determination that either or both (I) should be not be regulated as swaps, and (II) are not structured to evade the bill.
 - Grants the CFTC jurisdiction over puts, calls and options on securities exempted by the SEC, and the SEC jurisdiction over products exempted by the CFTC.
- **Identified Banking Products**
 - Excludes from CFTC jurisdiction, and the definitions of security-based swap and security-based swap agreement, the following “identified banking products”: (1) a deposit account, savings account, certificate of deposit, or other deposit instrument issued by a bank; (2) a banker’s acceptance; (3) a letter of credit issued or loan made by a bank; (4) a debit account at a bank arising from a credit card or similar arrangement; and (5) a participation in a loan which the bank or affiliate of the bank (other than a broker or dealer) funds, participates in, or owns that is sold to certain persons. Exclusion does not extend to swap agreements that would otherwise qualify as identified banking products under Section 206 of the Gramm-Leach-Bliley Act.
 - Authorizes the appropriate Federal banking agency to except an identified banking product from the exclusion above if it determines, in consultation with the CFTC and the SEC, that the product (i) would meet the definition of swap or security-based swap and (ii) is known to the trade as a swap or security-based swap or otherwise has been structured to evade the Commodity Exchange Act or the Securities Exchange Act. If the bank is not under the jurisdiction of an appropriate Federal banking agency and conditions (i) and (ii) are satisfied, the product will be excepted from the exclusion.
 - Deletes the exemption from the Commodity Exchange Act provided by the Legal Certainty for Bank Products Act for covered swap agreements offered, entered into, or provided by a bank.

- **Business Conduct Standards**
 - Authorizes the CFTC/SEC to adopt business conduct requirements for swap dealers and major swap participants.
- **Clearing Requirements**
 - Imposes a central clearing requirement on all swaps, unless an exemption applies.
 - Exempts (i) swaps for which no clearing house will accept the swap for clearing and (ii) swaps entered into by a “commercial end user” using the swap to hedge commercial risk.
 - Defines “commercial end user” as any person other than a financial entity “who, as its primary business activity, owns, uses, produces, processes, manufactures, distributes, merchandises, or markets goods, services, or commodities (which shall include but not be limited to coal, natural gas, electricity, ethanol, crude oil, gasoline, propane, distillates, and other hydrocarbons) either individually or in a fiduciary capacity.”
 - Defines “financial entity” to include (I) a swap dealer or major swap participant; (II) a person predominantly engaged in activities that are in the business of banking or financial in nature, as defined in the Bank Holding Company Act; (III) a person predominantly engaged in activities that are financial in nature; (IV) a commodity pool as described in the Commodity Exchange Act or a private fund as defined in the Investment Advisers Act (as amended); or (V) certain persons that are registered or required to be registered with the CFTC or SEC, as applicable.
 - Authorizes affiliates of commercial end users (explicitly including affiliate entities predominantly engaged in providing financing for the purchase of the merchandise or manufactured goods of the commercial end user) to utilize the exemption if the financing affiliate, acting on behalf of the commercial end user and as an agent, uses the swap to hedge or mitigate the commercial risk of the commercial end user parent or other affiliate of the commercial end user that is not a financial entity; provided that the affiliate is not a swap dealer, major swap participant, issuer that would be an investment company under Section 3 of the Investment Company Act outside of the paragraph (c)(1) and (c)(7) exemptions from the definition of “investment company,” commodity pool, bank holding company with over \$50 billion in consolidated assets, or affiliate of any such entity.
 - To use the commercial end user exemption, requires an entity that is an issuer of registered securities or reports under the Exchange Act to have its audit committee review and approve the use of swaps subject to the exemption.
 - Requires CFTC/SEC approval for a swap or group, category, type or class of swaps to be cleared, and the CFTC/SEC to make applications for approval public.
 - Authorizes CFTC/SEC to adopt rules under expedited procedures to identify a particular swap or groups, categories, types or classes of swaps not submitted by a clearing house that the CFTC/SEC deems should be required to be cleared.
 - Requires nondiscriminatory clearing of swaps executed bilaterally or on or through the rules of an unaffiliated designated contract market/national securities exchange or swap execution facility.
 - Requires clearing houses to prescribe that all swaps with the same terms and conditions are economically equivalent and may be offset within the clearing house.
 - Requires that all non-cleared swaps be reported to a registered swap repository or the CFTC/SEC, which must make public aggregate data on all cleared and non-cleared swaps. Swaps entered into prior to the application of the clearing requirement are not required to be cleared if reported within specified timeframes.

- Requires large swap traders to keep books and records of any cash or spot transactions or positions in, inventories of, and purchase and sale commitments of, any related commodity traded on or subject to the rules of any board of trade.
- Authorizes the CFTC/SEC to stay the mandatory clearing requirement, after approving a clearing house's listing petition, while reviewing the relevant swap or group, category, type or class of swaps.
- Requires registered entities, in order to elect to list for trading or accept for clearing any new contract or other instrument or elect to approve and implement any new rule or rule amendment, to provide the CFTC/SEC (and the Treasury in the case of contracts of sale of a government security) a written certification that the new contract or instrument or clearing of the new contract or instrument, new rule, or rule amendment complies with the bill.
- **Trade Execution Requirements**
 - Requires that all swaps that are subject to the clearing requirement be traded on a board of trade designated as a contract market or a securities exchange or through a swap execution facility, unless no such entity accepts the swap for trading.
 - "Swap execution facility" is defined for purposes of the Securities Exchange Act as a "facility in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by other participants that are open to multiple participants in the facility or system, *or confirmation facility*, that (A) facilitates the execution of security-based swaps between persons; and (B) is not a designated contract market." (emphasis added)
 - "Swap execution facility" is defined for purposes the Commodity Exchange Act as a "facility 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, *through any means of interstate commerce, including any trading facility*, that (A) facilitates the execution of swaps between persons; and (B) is not a designated contract market." (emphasis added)
 - *N.B. It is unclear whether the inclusion of "confirmation facility" in the security-based swap execution facility definition and NOT in the CFTC-regulated swap execution facility definition is an intentional inconsistency or which way the inconsistency will be resolved.*
 - No exemption for swap execution facilities from registration as brokers or exchanges.
 - Requires each derivatives clearing organization to have financial resources that exceed the total amount that would (i) enable the organization to meet its financial obligations to its members and participants notwithstanding a default by the member or participant creating the largest financial exposure in extreme but plausible market conditions and (ii) enable the organization to cover its operating costs for a period of 1 year (as calculated on a rolling basis).
 - Requires all contracts with non-eligible contract participants to be exchange-traded.
 - Requires a registration statement to be in effect to offer to sell, offer to buy or purchase or sell a security-based swap to a non-eligible contract participant.
- **Public Reporting of Swap Transaction Data**
 - Requires the CFTC/SEC to promulgate rules for real-time public data reporting of swap transaction and pricing data for (i) swaps subject to mandatory clearing, including those exempted by the commercial end user exemption and (ii) swaps not subject to the mandatory clearing requirement that are cleared at a clearing agency.

- Requires the rules promulgated to (i) ensure that the information provided does not identify the participants; (ii) specify criteria for what constitutes a large notional swap transaction (“block trade”) for particular markets and contracts; (iii) specify the appropriate time delay for block trade data reporting; and (iv) take into account whether the public disclosure will materially reduce market liquidity.
- Requires the CFTC/SEC to promulgate rules for public reporting of aggregate data on swap trading volumes and positions for uncleared swaps that are reported to a swap data repository or the CFTC/SEC in a way that does not disclose the business transactions and market positions of any person.
- **Capital and Margin Requirements**
 - Imposes capital and margin requirements on swap dealers and major swap participants as set by the relevant regulator (appropriate Federal banking agency for banks, CFTC/SEC for non-banks), with capital requirements required to be substantially higher for non-cleared swaps.
 - Gives regulators discretion to allow for use of non-cash collateral to meet margin requirements.
 - Provides a limited exemption to the margin requirements for uncleared swaps if one of the counterparties is not a (i) swap dealer, (ii) major swap participant or (iii) a financial entity, and such counterparty is eligible for and utilizing the commercial end user clearing exemption.
 - Authorizes the CFTC to alter or supplement the rules of a registered entity related to margin under certain circumstances, but it cannot set specific margin amounts.
- **Segregation of Collateral and Bankruptcy**
 - Requires any entity accepting money, securities or property, or extending credit in lieu of money, securities or property from, for, or on behalf of a swaps customer to margin, guarantee, or secure a swap cleared by or through a clearing house to be a registered futures commission merchant if the contract is a CFTC-regulated swap, or a registered broker, dealer or security-based swap dealer if the contract is a security-based swap.
 - Subject to limited exceptions, requires futures commission merchants, brokers, dealers and security-based swap dealers to treat and deal with money, securities and property of swaps customers received to margin, guarantee or secure cleared swaps as belonging to the swap customer and to account for and not commingle such property of swaps customers with their own funds or use that property to margin, secure or guarantee trades or contracts of other persons.
 - Prohibits clearing houses and depositories from holding, disposing of or using property required to be segregated as described above as belonging to the futures commission merchant, broker, dealer or security-based swap dealer or any person other than the swaps customer of the futures commission merchant, broker, dealer or security-based swap dealer.
 - At the option of a counterparty to an uncleared swap, requires CFTC-regulated swap dealers and major swap participants to (i) segregate initial margin for the counterparty’s benefit and (ii) maintain initial margin in an account designated as a segregated account for and on behalf of the counterparty at a third-party custodian separate from the assets and other interests of the swap dealer or major swap participant.
 - *N.B. There is no similar segregation election available for counterparties to security-based swaps.*
 - Expands the definition of “commodity contract” in the Bankruptcy Code to include cleared CFTC-regulated swaps.

▪ **Position Limits**

- Authorizes the CFTC to establish aggregate position limits on the amount of trading or positions by a person, including a group or class of traders, in swaps traded on or subject to the rules of a swap execution facility or swaps that otherwise perform a significant price discovery function with respect to a registered entity.
- Authorizes the SEC to establish aggregate position limits across security-based swaps that may be held by any person, including positions in any security-based swap and any security or group or index of securities, the price, yield, value, or volatility of which, or of which any interest therein, is the basis for a material term of such security-based swap.
- Requires designated contract markets and swap execution facilities to establish and enforce position limits or position accountability requirements.

▪ **Extraterritoriality**

- The provisions relating to CFTC-regulated swaps do not apply to activities outside the United States unless those activities “(1) have a direct and significant connection with activities in, or effect on, commerce of the United States or (2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any [provision].”
- The provisions relating to security-based swaps added to the Exchange Act do not apply to activities outside the jurisdiction of the United States unless a person transacts a business in security-based swaps in contravention of the rules and regulations promulgated by the SEC to prevent evasion of the bill.

▪ **Exchange Act Beneficial Ownership Reporting**

- Amends Sections 13(d), 13(f) and 13(g) of the Exchange Act to include within their beneficial ownership reporting requirements a market participant who “becomes or is deemed to become a beneficial owner [of a security] upon the purchase or sale of a security-based swap” under SEC rules.

▪ **Rulemaking and Effectiveness**

- Allows persons filing a proposal to list or trade a novel derivative product that may have elements of both securities and futures to provide notice to each Commission, and each Commission must notify the other of receipt of such a notice. If no such notice is filed, each Commission must notify the other if they receive a petition to list a novel derivative product with elements of both securities and futures. Each Commission may request that the other determine the status of the product or that the other exempt the product. The applicable Commission must determine the status of the product within 120 days. This determination can be appealed to the US Court of Appeals for the DC Circuit, where the proceeding will be expedited and there will be no deference to either Commission’s view.
- Unless specified otherwise in the bill, the CFTC/SEC must individually promulgate required rules within 180 days of passage the bill.
- Except where otherwise indicated in the bill, the provisions of the bill become effective 180 days after its enactment.

▪ **Conflicts of Interest**

- Requires the CFTC/SEC to, within 180 days of enactment, determine whether to promulgate rules to establish limits on the control of any swaps clearing house or swaps exchange by a bank holding company with consolidated assets of \$50 billion or more, nonbank financial company

supervised by the Fed, affiliate of such a bank holding company or nonbank financial company, swap dealer, major swap participant, or associated person of a swap dealer or major swap participant. If the CFTC or SEC finds that the rules are necessary or appropriate to improve the governance of, mitigate systemic risk, promote competition or mitigate conflicts of interest in connection with a swap dealer or major swap participant's conduct of business with a clearing house or exchange in which such dealer or participant has a material debt or equity investment, the CFTC or SEC must adopt such rules.

▪ **Enforcement Authority, Insider Trading, Disruptive Practices and Whistleblowers**

- Grants the CFTC and SEC increased enforcement authority related to swaps.
- Grants the CFTC increased insider trading and antidisruptive practices authority.
- Requires the CFTC to pay an award, to whistleblowers who voluntarily provide "original information" that leads to the successful enforcement of a judicial or administrative action (or related action) brought under the Commodity Exchange Act that results in monetary sanctions exceeding \$1 million, of not less than 10%, in total, or up to 30%, in total, of the monetary sanctions that have been collected in such action, in the CFTC's discretion. A "Commodity Futures Trading Commission Customer Protection Fund" is created in the Treasury for the payment of awards to whistleblowers and customer protection education initiatives.

▪ **Eligible Contract Participants**

- Requires government entities, political subdivisions, multinational or supranational government entities, and any instrumentality, agency or department of any of the above to own or invest on a discretionary basis \$50 million or more in order to qualify as an "eligible contract participant."
- Requires individuals to invest \$10 million (or \$5 million if the contract is entered into to manage a risk associated with an asset owned or liability incurred, or reasonably likely to be owned or incurred by the individual) or more on a discretionary basis in order to qualify.

Credit Retention Requirements

- **Key regulators.** Regulation of asset-backed securities by the OCC, FDIC and SEC.
- **Credit Retention Requirements.** Federal banking agencies and SEC to jointly prescribe standards that require securitizers of asset-backed securities, by default, to maintain 5% of the credit risk in assets transferred, sold or conveyed through the issuance of an asset-backed securities by the securitizer; regulators have flexibility to impose lower-than-5% risk retention if underwriting/diligence meets certain prescribed underwriting standards specific to the class of the securitized asset; regulators may allocate this obligation between the securitizer and originator in the case of a securitizer that purchases assets from an originator.
 - Asset-backed security is defined as a "fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset," specifically including collateralized mortgage obligations, collateralized debt obligations (CDOs), collateralized bond obligations, CDOs of asset-backed securities, CDOs of CDOs, and any security that the SEC determines to be an asset-backed security for this purpose.
 - Exclusion for securities "issued by a finance subsidiary held by the parent company or a company controlled by the parent company, if none of the securities issued by the finance subsidiary are held by an entity that is not controlled by the parent company."

- Securitizer is defined as "(A) an issuer of an asset-backed security; or (B) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer."
- Originator is defined as "[a] person who: (A) through the extension of credit or otherwise, creates a financial asset that collateralizes an asset-backed security; and (B) sells an asset to a securitizer."
- **"Qualified Residential Mortgage" Carve-Out.** Does not require a securitizer to retain any part of the credit risk for an asset that is transferred, sold or conveyed through the issuance of an asset backed security by the securitizer, if all of the assets that collateralize the asset backed security are qualified residential mortgages, which generally are mortgages that satisfy high underwriting standards
 - Federal banking agencies, the SEC, the Secretary of HUD, and the Director of FHFA to jointly issue regulations to exempt qualified residential mortgages from the risk retention requirements of this subsection and to jointly define the term "qualified residential mortgage." However, such regulations cannot exempt an asset backed security that is collateralized by tranches of other asset-backed securities.
 - SEC must require an issuer to certify, for each issuance of an asset backed security collateralized exclusively by qualified residential mortgages, that the issuer has evaluated the effectiveness of the internal supervisory controls of the issuer with respect to the process for ensuring that all assets that collateralize the asset backed security are qualified residential mortgages.
- **No Hedging of Retained Credit Risk.** Prohibits the covered party from hedging the required retained credit risk.
- **Sharing of Risk Retention by Securitizer and Originator.** Amount of risk retention required of a securitizer to be reduced by the amount of risk retention required of the originator.
- **Exemptive Authority.** Federal banking agencies and SEC can jointly adopt or issue exemptions, exceptions or adjustments to the risk retention rules.
- **Asset Classes.** Regulators to establish different asset classes with different credit retention rules, including asset-backed securities backed by residential mortgages, commercial mortgages, commercial loans, auto loans, and any other class of assets deemed appropriate.
- **Timeframe.** Regulators required to prescribe regulations within 270 days after the date of enactment. Regulations are effective one year after publication of the final rules in the Federal Register for residential mortgage-backed securities, 2 years for all other classes of securities.
- **Heightened Reporting and Disclosure.** Requires heightened reporting and disclosure related to asset-backed securities.
- **Disclosure of Repurchase Request.** Requires that securitizers disclose both fulfilled and unfulfilled repurchase requests across all trusts aggregated by the securitizer.
- **Removal of Exemption from Registration.** Deletes the exemption from registration for certain specific categories of mortgage backed securities provided by Section 4.
- **Due Diligence Analysis and Disclosure.** Within 180 days of enactment, requires the SEC to issue rules relating to the registration statement required to be filed by an issuer of an asset backed security requiring the issuer to perform a due diligence analysis of the assets underlying the asset backed security and to disclose the nature of the analysis.

Payment, Clearance and Settlement

- **Payment, Clearance and Settlement Addressed in Proposal.** Dropped from the House bill during the legislative process, the payment, clearing and settlement section is included in the Senate bill.
- **Key Points.** Allows for the designation of systemically important financial market utilities and payment, clearing and settlement activities of financial institutions.
- Systemically important financial market utilities and payment, clearing and settlement activities of financial institutions are subject to extensive supervision by the Fed and the supervisory agency of the institution.
 - Payment, clearing and settlement activities of financial institutions potentially can include their normal back office activities.
- Designation provides access to the Fed's discount window for systemically important financial market utilities.

Changes in Broker-Dealer Regulation and Investor Protection

Broker-Dealer Regulation

- **Fiduciary Duty Study.** Requires an SEC study of the effectiveness of existing standards of care for broker-dealers and investment advisers for providing personalized investment advice and recommendations about securities to retail customers. The topics to be addressed are expressly prescribed in the bill. The SEC is required to seek and consider public input, comments and data. If the study concludes that gaps or overlaps exist, SEC required to commence a rulemaking under its existing statutory authority within 2 years of the enactment of the bill.
 - House bill requires the SEC to impose a fiduciary duty on broker-dealers providing investment advice about securities to retail customers.
- **Short Sales.** No provision to require institutional investment managers to provide the SEC with daily reports regarding short sales, as was included in the House bill.
- **Securities Lending.** Requires the SEC, within 2 year after the enactment of the bill, to promulgate rules designed to increase the transparency of information available regarding securities lending. No similar mandate is included in the House bill.
- **Portfolio Margining.** Encourages portfolio margining by providing SIPC protection to futures and options on futures in portfolio margining accounts; does not resolve futures segregation obstacles.
- **SRO Filing Procedures**
 - SRO rules would become effective if the SEC fails to approve or disapprove the rule filing within specified times. The effective of date of the rule filing, which triggers the time periods, is the date of publication of the rule filing in the Federal Register, unless the SEC fails to send the filing to the Federal Register for filing within 15 days after the filing is posted on the SRO's website. In this case, the date of publication is deemed to be the date the notice is published on the SRO's website.
 - The category of rule filings that are "effective on filing" would be expanded to include fees charged to non-members, such as market data fees.
- **Point of Sale Disclosures.** Provides the SEC with express authority to issue rules designating disclosure that must be provided by a broker-dealer to a retail investor before the purchase of an investment product or service by the retail investor. Requires that any documents or information that

the SEC requires to be disclosed to retail investors include information about investment objectives, strategies, costs, and risks, and any compensation or financial incentive received by a broker-dealer or other intermediary in connection with the retail customer's purchase of the product.

- **Investor Advisory Committee / Investor Advocate / Investor Testing**
 - Establishes an Investor Advisory Committee with membership that represents, among others, individual investors and state securities commissions. SEC is required to issue a public statement assessing any findings or recommendations of the committee.
 - Establishes an Office of Investor Advocate, appointed by, and reporting directly to, the SEC Chairman, that is charged with assisting retail investors.
 - Provides the SEC with express authority to engage in investor testing programs.
- **Studies Regarding Financial Literacy and Mutual Fund Advertising**
 - SEC is required to study the financial literacy of retail investors.
 - GAO is required to study mutual fund advertising.
 - **GAO Study on Conflicts of Interest.** Requires a new GAO study within 18 months after the enactment of the bill regarding the potential conflicts of interest that exist between securities underwriting and securities analyst functions within the same firms.
 - **SEC Study on Investor Access to Information About Investment Advisers and Broker-Dealers.** Requires a new SEC study within 6 months after the date of enactment of the bill regarding ways to improve access of investors to registration information about investment advisers, broker-dealers and their associated persons, and requires the SEC to implement any recommendations of the study.
 - **GAO Study on Financial Planners.** Requires a new GAO study within 180 days after the enactment of the bill to evaluate the effectiveness of state and federal regulations to protect consumers from misleading financial advisor designations, oversight structure and regulations for financial planners and gaps in the regulation of financial planners.

Municipal Securities

- **Municipal Securities Advisors and MSRB Authority**
 - Requires registration and oversight of municipal advisors that provide advice to, or undertake solicitation of, issuers of municipal securities with respect to the issuance of municipal securities, investment of proceeds of municipal offerings or derivatives on municipal securities.
 - Clarifies that the term municipal advisor does not include broker-dealers or municipal securities dealers serving as an underwriter, any investment adviser registered under the Investment Advisers Act, or persons associated with such investment advisers who are providing investment advice, attorneys offering legal advice or providing services that are of a traditional legal nature, or engineers providing engineering advice.
 - Expands the rulemaking authority of the Municipal Securities Rulemaking Board ("**MSRB**") over broker-dealers, municipal securities dealers and municipal advisors with respect to the issuance of municipal securities, investment of proceeds of municipal offerings or derivatives on municipal securities. Otherwise provides the MSRB with rulemaking authority regarding municipal advisors comparable to its authority regarding municipal securities dealers. Extends MSRB rulemaking authority over sales by a broker-dealer of any part of a new issue of municipal securities to a related account during the underwriting period and solicitation of municipal entities.

- Expands the MSRB's authority to regulate advice provided to or on behalf of "obligated persons," which includes any person who is committed to support the payment of all or part of the obligations on municipal securities.
- Requires the MSRB to adopt rules that require continuing education requirements for municipal advisors and professional standards.
- Requires MSRB rules to not impose an inappropriate regulatory burden on small municipal advisors.
- Reconstitutes the MSRB with a majority of board members that are not affiliated with broker-dealers, municipal dealers or municipal advisors.
- Authorizes the MSRB to impose penalties for violations of its rules.
- Authorizes the MSRB to assist the SEC and FINRA in examinations and enforcement actions regarding MSRB rules, and retain half of any penalties imposed by the SEC in such enforcement actions.
- Authorizes the MSRB to establish information systems and impose fees for submission of information to these systems.
- Formalizes within the SEC an Office of Municipal Securities.
- **Municipal Security Studies**
 - Requires the GAO to study the value of enhanced municipal issuer disclosure, and the repeal of the Tower Amendment prohibition on the MSRB requiring issuer disclosure.
 - Requires the GAO to study the municipal securities markets, including an analysis of the mechanisms for trading, quality of trade executions, market transparency, trade reporting, price discovery, settlement, clearing, and credit enhancements, and how to improve transparency, fairness and liquidity.
 - Requires the SEC to study the funding mechanism for the Government Accounting Standards Board.

Capital Markets

- **Disqualifying Felons and other "Bad Actors" from Regulation D Offerings.** Requires that the SEC issue rules disqualifying an offering or sale of securities as a Regulation D offering where the person offering the securities:
 - Has been convicted of a felony or misdemeanor in connection with purchase or sale of any security or in connection with a false filing with the SEC; or
 - Is barred from association with regulated entities or from engaging in the business of securities, insurance, banking or in savings association or credit union activities for fraud, manipulation or deception.
- **Clarification that Section 205 of the Investment Advisers Act Does not Apply to State Registered Advisers.** Revises Section 205 to clarify that any investment adviser not registered or required to be registered with the SEC is not subject to Section 205's restrictions on investment advisory contracts. Deletes the condition that investment advisers must use mails or any means or instrumentality of interstate commerce in order to be subject to Section 205.

Securities Laws Enforcement

- **SEC Authority to Restrict Mandatory Pre-Dispute Arbitration.** Authorizes the SEC to conduct rulemaking reaffirming or prohibiting the use of mandatory arbitration pre-dispute agreements between broker-dealers and investment advisers.
 - The House bill provides the SEC with authority to conduct rulemaking that would only prohibit or limit arbitration.
- **SEC's Aiding and Abetting Authority.** The Senate bill does not include provisions to expand the SEC's authority to pursue aiders and abettors of securities laws violators, or extend this authority under the Securities Act, Investment Company Act, and Advisers Act.
- **Whistleblower Protection.** Authorizes the SEC, in any action in which it levies sanctions in excess of \$1 million to compensate whistleblowers who provide original information with between 10% and 30% of the amount of the sanctions, an increase from the SEC's current authority under the Exchange Act, which caps such compensation at 10% of collected penalties, and restricts it to the insider trading context.
 - Also establishes an Investor Protection Fund, intended to grow to a maximum of \$200 million through revenues from certain sanctions.
 - Provides whistleblowers with an express private right of action against employers who retaliate against them. Prohibits awards to auditors whose submission would violate 10A of the Exchange Act.
 - Extends whistleblower protection to employees of NRSROs.
 - Very similar to the House bill.
- **Extends whistleblower protection.** Subjects subsidiaries and affiliates that are consolidated with public companies for financial accounting purposes to the Sarbanes Oxley whistleblower provisions.
- **Collateral Bars.** Permits the SEC to impose collateral bars under the Exchange Act and the Advisers Act, prohibiting offenders from associating with a broad range of SEC regulated entities, rather than only those entities regulated under the particular statutory provisions under which the violation occurred.
 - Same as House bill.
- **No Private Civil Action for Aiding and Abetting.** The Senate bill does *not* include a provision allowing for private civil actions against individuals who *knowingly or recklessly* aid or abet a violation of the Exchange Act.
- **Authority to Share Certain Information with Foreign Authorities.** Amends the Sarbanes-Oxley Act to provide for the sharing of information with foreign auditor oversight authorities without waiving confidentiality or privilege.
 - Unlike the House bill, requires the foreign authority give a description of the applicable information systems and controls that it has in place, as well as the laws and regulations of the foreign authority that are relevant to information access.

SEC Management

- **Report and Certification of Internal Supervisory Controls.** Requires the SEC to submit a yearly report to Congress that contains an assessment of the effectiveness of the internal supervisory

controls of the SEC and the procedures that SEC staff use to perform examinations, investigations, and reviews of entities.

- **Triennial Report on Personnel Management.** Requires the GAO to submit a triennial report to Congress that evaluates the following areas in the SEC: the effectiveness of supervisors, promotion decisions, communication between different units of the SEC, turnover, whether there are excessive numbers of managers, initiatives to improve staff competency, and actions taken regarding employees who fail to perform their duties.
 - The report must also include recommendations on how the SEC can use human resources more effectively.
 - The SEC must submit a response 90 days after the GAO report is submitted detailing its response to the recommendations.
- **Annual Financial Controls Audit.** The SEC must submit a yearly report to Congress describing and assessing the SEC's establishment and maintenance of an adequate internal control structure and procedures for financial reporting.
 - Requires a similar report from the GAO.
- **Report on Oversight of National Securities Associations.** Requires the GAO to submit a report on the oversight by the SEC of national securities associations to Congress once every 3 years that evaluates: the governance of such associations; the examinations carried out by such associations; the executive compensation of such associations; arbitration services provided by such associations; the review performed by such associations on advertising by its members; the cooperation between such associations and state securities administrators to promote investor protection; the funding of such associations; the policies of such associations regarding employment of former employees of such associations by regulated entities; the effectiveness of the rules of such associations in achieving the goals of the rules; the transparency of such associations; and the effectiveness of such associations along with both public and internal confidence in such associations.
- **Compliance Examiners.** Provides the Division of Trading and Markets and the Division of Investment Management of the SEC with a staff of examiners to perform compliance inspections and examinations of entities under the jurisdiction of those Divisions.
 - Effectively reorganizes the Office of Compliance Inspections and Examination.
- **Suggestion Program for Employees of the Commission.** The Inspector General of the SEC must establish a hotline for the receipt of suggestions by employees of the SEC for improvements and allegations by employees of waste, abuse, misconduct, or mismanagement.
 - Requires Inspector General to take appropriate action in response to such suggestions and allegations. Also requires a yearly report to Congress on such suggestions and allegations.
- **Provides for Self-Funding for the SEC.** Requires the Chairman of the SEC to submit a budget to Congress, but this is not considered a request for appropriations and the amount requested would automatically be given to the SEC.
 - The House bill provided the SEC with a set (though increased) budget.

PCAOB and Inspectors General

- **PCAOB Review of Auditors of Broker-Dealers.** Extends the authority of the Public Company Accounting Oversight Board (the "PCAOB") to include auditors of registered broker-dealers. Permits PCAOB to refer investigations, as well as release documents and information gathered in investigations, to a registered broker-dealer's SRO.

- Effective 180 days after the Act.
- Under current law, auditors of registered broker-dealers must be registered with the PCAOB. However, these auditors are not otherwise subject to the PCAOB oversight, which applies only to public companies.
- Same as the House bill.
- **Changes in Appointments of Certain Inspectors General.** Requires presidential appointment and Senate approval for the Inspectors General of the Federal Reserve, the Commodity Futures Trading Commission, the National Credit Union Administration, the Pension Benefit Guaranty Corporation, the SEC, and the Consumer Bureau.
 - With the exception of the Consumer Bureau, requires the heads of each of these entities to address deficiencies identified by a report or investigation of the Inspector General of the entity.
- **Changes in Appointments of Certain Inspectors General.** Changes the way powers are delegated to the Inspectors General of the Federal Labor Relations Authority, the National Archives and Records Administration, the National Credit Union Administration, the National Endowment for the Arts, the National Endowment for the Humanities, and the Peace Corps.
 - If a board of commission is the head of the designated Federal entity, removal of an Inspector General may only be made by a 2/3 majority of that board of commission. With the exception of the Consumer Bureau, requires the heads of each of these entities to address deficiencies identified by a report or investigation of the Inspector General of the entity.
 - Establishes a Council of Inspectors General on Financial Oversight that will facilitate the sharing of information about Inspectors General.

Corporate Governance

- **No Shareholder Vote on Staggered Terms of Directors.** Does not include a provision that limits companies from having boards with staggered terms without shareholder approval or ratification.
- **Proxy Access.** The SEC “may”, but is not required, to issue rules permitting shareholders to use issuer proxy solicitation materials to nominate director candidates.
- **Majority Voting.** Listed companies must require that directors are elected in uncontested elections by a majority of the votes cast (the plurality standard applies if the election is contested). Directors who receive less than a majority of the votes cast must tender their resignation and the board must accept the resignation within a period of time as disclosed or decline to accept the resignation and publicly provide the reasons, together with a discussion of the analysis used in reaching the conclusion, within 30 days.
- **Chairman and CEO Structure Disclosure.** Requires the SEC, within 180 days after enactment, to issue rules requiring companies to disclose in the proxy statement why the same or different persons serve as chairman and CEO.
- **Risk Committee Required** for systemically important, publicly traded nonbank financial companies that are supervised by the Fed, as well as publicly traded bank holding companies with total consolidated assets of \$10 billion or more. Risk committee must have the number of independent directors determined by the Fed (independence is not defined in this context), and include one risk management expert having experience in risk management at large complex companies.

Executive Compensation

- **No Say on Golden Parachutes.** Unlike the House bill, does not provide for shareholder approval of golden parachutes.
- **Hedging Disclosure for Employees and Directors.** Requires companies to disclose whether employees and directors are allowed to hedge the value of any equity securities.
- **No Express Requirement for Independence of Compensation Committee Advisors.** Independence of consultants, legal counsel and other advisors to be engaged by compensation committees must be taken into account.
 - Like the House bill, provides that listed companies must have a compensation committee consisting of independent directors, and authorizes compensation committees to engage consultants, legal counsel and other advisors. Compensation committees are directly responsible for the appointment, compensation and oversight of the work of such advisors and are required to disclose whether a compensation consultant was retained.
- **Pay and Performance Disclosure.** Requires the SEC to amend Item 402 of Regulation S-K to require companies to disclose the relationship between a company's executive compensation actually paid and financial performance, taking into account any change in the value of the company's shares, dividends and distributions.
- **Internal Pay Equity Disclosure.** Requires the SEC to amend Item 402 of Regulation S-K to require companies to disclose: (1) the median annual total compensation of all employees, except the CEO; (2) the annual total compensation of the CEO; and (3) the ratio of the median employee annual total compensation to that of the CEO. Annual total compensation for the purposes of this disclosure is calculated in accordance with the rules governing the calculation of the "Total" column in the Summary Compensation Table.
- **Broker Discretionary Vote Eliminated for Certain Matters.** Amends the Exchange Act to prohibit broker discretionary voting in connection with a shareholder vote with respect to the election of directors, executive compensation or any other significant matter, as determined by the SEC. Under this provision, listing exchanges are not prohibited from allowing broker discretionary voting on other matters. Last year, the SEC eliminated broker discretionary voting in director elections for meetings held on or after January 1, 2010.
- **Say on Pay.** Provides that at any annual meeting of shareholders, or special meeting in lieu thereof, held within 6 months after the bill's enactment, companies must provide their shareholders with an annual non-binding shareholder vote to approve the compensation of executives as disclosed pursuant to the SEC rules.
- **Clawback.** The listing exchanges are directed to enforce the implementation of policies on incentive-based compensation that is based on publicly reported financial information and clawback policies enabling the recovery of incentive-based compensation from current or former executive officers following a restatement. The trigger would be based on material noncompliance with any financial reporting requirements that led to the restatement, during the three-year period preceding the date on which a company is required to prepare the restatement. The amount to be clawed back is the amount in excess of what would have been paid under the restated results.
- **Executive Compensation at Financial Institutions.** Requires the Fed to consult with the OCC and the FDIC, rather than act alone, in establishing standards making it an unsafe and unsound practice for the holding companies of depository institutions to provide an employee, director or principal shareholder with compensation that is excessive or could lead to material financial loss to the bank holding company. Also directs the appropriate bank regulator to prohibit such unsafe and unsound practices.

Insurance

- The Senate bill would create an Office of Insurance (“ONI”) within Treasury with certain limited powers, much like the House bill. Although not an optional federal regulator for which some continue to lobby, the ONI would have real, though limited, powers, and could portend increased federal involvement in the industry. In addition, the Senate bill would enact legislation, previously passed several times by the House of Representatives, designed to streamline the market for nonadmitted insurance and reinsurance.

Office of National Insurance

- **Functions and Powers.** In addition to any other assigned duties, the ONI would monitor the insurance industry, recommend to the Council any insurers that should be treated as systemically important, assist in administering the Terrorism Insurance Program, represent the U.S. in the International Association of Insurance Supervisors and determine whether state insurance measures are preempted by international agreements.
 - The ONI’s information-gathering powers, which extend to any insurer that meets a minimum size threshold that may be established, includes the authority to issue subpoenas, which was not provided for in the House bill. However, the ONI is still required to coordinate with other relevant regulators to determine if information is otherwise available before requiring it to be provided by an insurer.
 - Authorizes ONI to require submission of data or information from any person authorized to write insurance or reinsurance risks and issue contracts or policies in at least one state.
 - The Senate bill also contains a savings provision specifying that it will not be construed to affect development of U.S. trade policy, as well as a requirement that the Treasury Secretary consult with U.S. Trade Representative before concluding any international insurance agreement.
- **Preemption.** The Senate bill grants the ONI power to preempt any state insurance regulation that results in less favorable treatment of a non-U.S. insurer as compared to a U.S. insurer admitted in the state and is inconsistent with an international agreement on prudential measures.
 - The ONI must notify and consult with the relevant state regulator prior to making a preemption determination.
- **Report.** The Senate bill also has provision, not included in the House bill, that requires the director of the ONI, within 18 months, to submit a report to Congress on improving U.S. insurance regulation, which must cover, among other things: costs and benefits of potential federal regulation of insurance; feasibility of regulating only certain lines at the federal level; ability of federal regulation to minimize regulatory arbitrage; developments in the international regulation of insurance; ability of federal regulation to provide robust consumer protection; and potential consequences of subjecting insurance companies to a federal resolution authority.

State-Based Insurance Reform

- **Background.** The Nonadmitted and Reinsurance Reform Act, included in the Senate bill, is substantially identical to bipartisan legislation which was unanimously passed by the House on September 9, 2009 before being subsequently referred to the Senate Committee on Banking, Housing, and Urban Affairs. Similar bills have passed in previous House sessions but have not been voted on by the Senate.

- Provisions are generally designed to streamline the market for nonadmitted insurance and reinsurance by limiting interstate application of regulation and encouraging implementation of uniform standards.
- **Nonadmitted Insurance Provisions.** The Senate bill would limit state regulatory authority with respect to nonadmitted insurance strictly to the home state of the insured, except with respect to certain workers compensation coverages. In addition, it would:
 - Prohibit states from imposing eligibility requirements on nonadmitted insurers domiciled in a U.S. jurisdiction except in conformance with the criteria set forth in the National Association of Insurance Commissioners (“NAIC”) model law or otherwise developed to be consistent across states,
 - Prohibit any state, other than an insured’s home state, from requiring a surplus lines broker to be licensed in order to sell nonadmitted insurance, and
 - Eliminate state prohibitions on surplus lines brokers procuring insurance from nonadmitted insurers domiciled outside the U.S. and included on an NAIC list.
 - The Senate bill also prohibits states, other than home state of the insured, from requiring premium tax payments for nonadmitted insurance and encourages the development of an interstate compact to provide for payment, collection and allocation of such taxes.
 - For certain sophisticated parties who request coverage from nonadmitted insurers, the Senate bill eliminates state requirements that surplus lines brokers undertake diligence searches to determine whether coverage can be obtained from admitted insurers. Such “exempt commercial purchaser” is defined as any person who retains a qualified risk manager to negotiate insurance coverage, has paid aggregate commercial property and casualty insurance premiums in excess of \$100,000, and meets one of another set of criteria (net worth, annual reviews, number of employees, etc.).
 - The Comptroller General is required to conduct a study to determine effect of legislation on the nonadmitted insurance market.
- **Reinsurance Provisions.** The Senate bill prohibits a state from denying credit for reinsurance if the state of domicile of the ceding insurer recognizes such credit. The bill also reserves the sole responsibility of regulating a reinsurer’s financial solvency to its state of domicile.
 - In each case, the home state must be NAIC-accredited or have requirements substantially similar to those necessary for accreditation.
 - It also prohibits a state from requiring a reinsurer to provide financial information other than that which it is required to file with its domiciliary state.

Hedge Fund Registration and Adjustments to Accredited Investor Thresholds

- **SEC Registration Required for a Broader Range of Advisers.** Like the House bill, eliminates the “private investment adviser” exemption contained in Section 203(b)(3) of the Investment Advisers Act.
- **“Private Fund” Definition.** Defines the term “private fund” to be any fund that would be an investment company but for the exemptions contained in Section 3(c)(1) or 3(c)(7) of the Investment Company Act. Definition the same as in the House bill.
- **Significant Registration Exemptions.** Exempts advisers to venture capital funds and private equity funds from SEC registration. Requires the SEC to promulgate rules defining the terms “venture capital fund” and “private equity fund” within 6 months of enactment.

- House bill does not exempt advisers to private equity funds from registration.
- **Family Offices.** Exempts family offices from the definition of the term “investment adviser,” placing such entities outside the purview of the Investment Advisers Act. Requires that the SEC define the term “family office,” for purposes of the exemption, in a manner consistent with its prior exemptive orders on the subject.
 - House bill does not contain a corresponding exemption.
- **Minimum Assets for SEC Adviser Registration.** \$100 million assets under management SEC registration threshold for state-regulated investment advisers.
- **Records and Reports.** Provisions relating to records and reports broadly similar to the House bill.
 - Among other provisions, requires advisers to private funds to maintain (but not necessarily to file with the SEC) certain records and reports pertaining to the following items, which are subject to SEC inspection: amount of assets under management; use of leverage; counterparty exposure; trading and investment positions; valuation policies and practices; types of assets held; side arrangements or side letters; trading practices and other information deemed necessary by the SEC, in consultation with the Council.
- **Proprietary Information.** Provides enhanced protection with regard to the confidentiality of any proprietary information provided to the government (*i.e.*, not subject to FOIA and disclosure by SEC staff to those outside of the SEC generally requires pre-approval)
 - Defines the term “proprietary information” to include: “(i) sensitive, non-public information regarding the investment or trading strategies of the investment adviser; (ii) analytical or research methodologies; (iii) trading data; (iv) computer hardware or software containing intellectual property; and (v) any additional information that the [SEC] determines to be proprietary.”
 - House bill employs identical definition.
- **Disclosure of Client Identity.** Modifies current Investment Advisers Act prohibition limiting the SEC’s ability to require investment advisers to disclose the identity, investments or affairs of their clients by adding an exception enabling the SEC to require the disclosure of such information insofar as such disclosure is sought “for purposes of assessment of potential systemic risk.”
- **Custody of Client Assets.** Allows for, but does not require, the SEC to promulgate rules to require registered investment advisers to take steps to safeguard client assets over which the adviser has custody. Suggests that such rules may, among other things, provide for verification of client assets by independent public accountants.
- **Accredited Investor Standard to be Adjusted for Inflation.** Adjusts the net worth threshold for accredited investor status with respect to natural persons.
 - Upon enactment of the bill, and for 4 years following the enactment of the bill, the net worth threshold will be \$1 million, excluding the value of the investor’s primary residence.
 - Subsequently, the SEC is required to increase any net worth threshold to an amount exceeding \$1 million, excluding the value of the investor’s primary residence.
 - Authorizes the SEC, upon enactment of the bill, to review the definition of the term “accredited investor,” as applied to natural persons, and to promulgate rules adjusting the provisions of the definition that do not relate to the net worth threshold.
 - Requires the SEC, 4 years after the enactment of the bill and every 4 years thereafter, to review the entirety of the definition of the term “accredited investor,” as applied to natural persons, and authorizes the SEC to modify the definition “as appropriate for the protection of investors, in the public interest, and in light of the economy.”

- Separately, extends the timeframe for the Comptroller General study on the appropriate thresholds and other criteria for accredited investor status and eligibility to invest in private funds to 3 years after the enactment of the bill.
- **Definition of “Client” for Purposes of 206(1) and 206(2).** Prohibits the SEC from defining the term “client” for purposes of Sections 206(1) and 206(2) of the Investment Advisers Act to include investors in a private fund. Consistent with current law.
- **One Year Transition Period.** Provisions generally become effective 1 year after enactment.

Credit Rating Agencies

- **Credit Rating Agency Regulation Generally**
 - Senate bill generally increases internal controls, requires greater transparency of rating procedures and methodologies, provides investors with a private right of action, provides the SEC with greater enforcement tools, and provides for SEC examination of nationally recognized statistical rating organizations (“NRSROs”).
 - House bill requires nearly all credit rating agencies to register as NRSROs and includes several unique provisions that do not appear in the Senate bill.
- **Accountability for Ratings Procedures**
 - **Internal Controls.** Each NRSRO must establish, maintain, enforce and document an internal control structure to govern implementation of and adherence to policies, procedures and methodologies for determining ratings.
 - SEC to require an annual internal controls report, including an attestation by the NRSRO’s CEO, to the SEC that describes management responsibility in establishing and maintaining internal control structure and assesses effectiveness of internal control structure.
- **Penalties for Certain Actions**
 - **Penalties.** Broadens penalties that SEC may impose to include fines and expands misconduct to which such penalties apply to include failure to reasonably supervise an individual who commits a violation of the securities laws.
 - **Suspension or Revocation of Registration.** Allows SEC to suspend or revoke registration of an NRSRO upon a determination, after notice and hearing, that the NRSRO lacks adequate financial or managerial resources to consistently produce ratings with integrity.
 - SEC must consider, among other factors, whether NRSRO failed to produce accurate ratings over a sustained period.
 - **No Antifraud Defense.** Clarifies that Exchange Act’s prohibition against regulating substance of credit ratings (or procedures and methodologies for determining ratings) may not be construed as affording a defense to an antifraud action or proceeding brought by the SEC.
- **Management of Conflicts of Interest.** SEC must issue rules to prevent sales and marketing considerations from influencing production of ratings, with exemptions possible for small NRSROs, if separation of ratings production and sales and marketing would not be appropriate.
 - If upon notice and hearing, SEC finds a violation that affected a rating, rules shall provide for suspension or revocation of the NRSRO’s registration.

- **Governance and Compliance**
 - **Independent Board.** Requires each NRSRO to have a Board of Directors with at least one-half, but no fewer than two, independent members, some portion of which must be users of NRSRO ratings and enumerates the Board's duties. When the NRSRO is a subsidiary, permits the parent's Board to satisfy requirements by assigning duties to a committee meeting certain independence criteria.
 - Exception possible for small NRSROs.
 - **Compliance Officer.** Designated compliance officer may not perform credit ratings or marketing or sales functions; participate in developing ratings methodologies or methods; or participate in establishing compensation levels (except for compliance personnel).
 - **Compliance Report.** Requires annual report submitted to NRSRO by the designated compliance officer on compliance with securities laws and policies and procedures. Report must describe material changes to code of ethics and conflict of interest policies and a certification of accuracy and completeness.
- **Establishment of SEC Office of Credit Ratings**
 - **Staffing.** Office of Credit Ratings is to have a director (reporting to SEC Chairman) and sufficient staffing, including persons with expertise in specified debt products, to carry out Office's duties.
 - **Duties.** Must establish fines and other penalties for violations by NRSROs and administer SEC rules: with respect to NRSRO practices in determining ratings; to promote accuracy in ratings; and to ensure ratings are not unduly influenced by conflicts.
 - **Annual Examination.** SEC shall conduct an annual examination of each NRSRO, including a review of: whether the NRSRO adheres to its policies, procedures and rating methodologies; the management of conflicts of interest; the implementation of ethics policies; the internal supervisory controls; the governance of the NRSRO; the activities of the designated compliance officer; the processing of complaints; and policies governing post-employment activities of former staff.
- **Initial Credit Ratings for Structured Finance**
 - **Credit Rating Agency Board.** Requires the SEC to establish a new self-regulatory organization (the "Board"), which will, through an application process, designate NRSROs as "qualified nationally recognized statistical rating organizations" with respect to specific categories of structured finance products and assign such qualified NRSROs to provide initial ratings to structured finance products. The Board will conduct an annual evaluation of the performance of each qualified NRSRO.
 - Issuers seeking an initial credit rating for a structured finance product must submit a request to the Board and may not request an initial rating from an NRSRO.
 - Initial ratings issued through this process will include a disclaimer that such initial ratings have not been evaluated, approved or certified by the U.S. government or any Federal agency.
 - Qualified NRSROs may charge a to-be-defined "reasonable fee" for an initial credit rating and the Board is authorized to issue rules on fees.
 - Board must be established no later than 180 days after enactment and the Board will begin assigning qualified NRSROs no later than 1 year later.

- **Procedures and Methodologies**
 - **Procedures and Methodologies Rules.** SEC must issue rules with respect to procedures and methodologies (including qualitative and quantitative data and models) used by NRSROs.
 - The rules must require each NRSRO to:
 - Ensure ratings are determined in accordance with procedures and methodologies approved by NRSRO's Board of Directors or the senior credit officer and in accordance with policies and procedures for development of such procedures and methodologies.
 - Ensure that when material changes to rating procedures and methodologies occur, they are applied consistently to all ratings to which they apply, including current ratings (to the extent surveillance procedures and methodologies are impacted), and the reason for the change is publicly disclosed.
 - Notify ratings users of: the version of a procedure or methodology used with respect to ratings; when a material change is made to a procedure or methodology and the likelihood of this resulting in a change to current ratings; when a significant error is identified in a procedure or methodology that may result in credit rating actions.
 - **Outside Information.** In producing a rating, an NRSRO must consider information about an issuer that it has or receives (other than from issuer), if it finds the information credible and potentially significant to the rating decision.
 - **Qualifications for Ratings Analysts.** SEC must issue rules to ensure persons employed to perform ratings are tested for knowledge of the rating process and meet standards of training, experience and competence necessary to produce accurate ratings.
 - **Rules to Establish Substantive Contours of a Rating.** SEC must issue rules requiring each NRSRO to establish, maintain and enforce policies and procedures that assess the probability that an issuer will default, fail to make timely payments, or otherwise not make payments in accordance with the terms of an instrument.
 - **Ratings Symbols.** SEC rules must require each NRSRO to establish, maintain and enforce policies and procedures that clearly define and disclose the meaning of any ratings symbol and that apply this symbol consistently for all instruments for which the symbol is used. An NRSRO may still utilize distinct sets of symbols to denote credit ratings for different types of instruments.
- **Disclosure**
 - **Ratings Performance.** For purposes of allowing assessment of accuracy and establishing comparability across NRSROs, SEC must issue rules to require each NRSRO to publicly disclose information on initial ratings and any subsequent changes.
 - **Form to Accompany Ratings.** SEC must, by rule, require each NRSRO to accompany the publication of each rating with a prescribed form disclosing information about: assumptions underlying procedures and methodologies; data relied upon to determine the rating; if applicable, how servicer or remittance reports were used, and how frequently, to conduct surveillance; other items that might help users of ratings better understand ratings in each class.
- **Private Right of Action**
 - **Statements Made by Credit Rating Agencies.** Establishes that enforcement and penalty provisions of the Exchange Act apply to statements made by credit rating agencies in the same manner and to the same extent as they apply to statements made by registered public accounting

firms or securities analysts under the securities laws. Clarifies that statements made by credit rating agencies are not forward looking statements for purposes of the Exchange Act's Section 21E safe-harbor.

- **State of Mind.** Modifies the requisite “state of mind” requirements for private securities fraud actions against a credit rating agency for money damages.
 - Sufficient to state with particularity facts giving rise to a strong inference that the credit rating agency knowingly or recklessly failed to conduct a reasonable investigation of a rated security with respect to factual elements relied upon by its own methodology or to obtain reasonable verification of such factual elements from sources independent of the issuer and underwriter that the credit rating agency considered competent.
 - House bill applies a “gross negligence” state of mind with respect to violations of the securities laws. House bill provides an additional private right for investors where the process of determining the rating was grossly negligent and a substantial factor in the investor’s economic loss. House bill also includes a provision that would nullify the effect of Rule 436(g) under the Securities Act.
- **Obligation to Report Violations of Law**
 - **Duty to Report Violations.** Each NRSRO must refer to law enforcement or regulatory authorities any information received from a third party that the NRSRO finds credible and that alleges that an issuer of securities rated by the NRSRO committed or is committing a material violation of law.
 - **Timing.** Unless otherwise specified, required rulemaking must be completed within 1 year of enactment.
 - **Removal of Statutory References.** Requires removal of statutory references to credit ratings from specified statutes effective 2 years from enactment.
 - Substantially identical to House bill with respect to removal of statutory references, but, unlike House bill, no longer requires that Federal Agencies modify regulations to remove references to, or reliance upon, credit ratings.
- **Studies and Reports**
 - **NRSRO Independence Study.** Requires SEC study of independence of NRSROs and how this affects ratings issued. Must evaluate, among other things, management of conflicts of interest by NRSROs providing non-rating services and potential impact of a prohibition on such services. Report to Senate Banking Committee and House Financial Services Committee on the results no later than 3 years after enactment.
 - House bill bans NRSROs and associated persons providing non-rating service.
 - **Alternative Business Model Study.** Comptroller General must conduct a study of alternative means for compensating NRSROs to create incentives to provide more accurate ratings.
 - Report to Senate Banking Committee and House Financial Services Committee on the results no later than 1 year after enactment.
 - **Independent Professional Analyst Organization Study.** Comptroller General must conduct a study on feasibility and merits of creating an independent professional organization for NRSRO rating analysts that would establish independent standards and an ethics code and oversee the profession. Report to Senate Banking Committee and House Financial Services Committee on the results no later than 1 year after enactment.

- **Standardization Study.** SEC must study the feasibility and desirability of standardizing credit ratings terminology across credit rating agencies and across asset classes; standardizing market stress conditions under which ratings are evaluated; and requiring a quantitative correspondence between ratings and a range of default probabilities and loss expectations under standardized stress conditions. Report to Congress on results no later than 1 year after enactment.

GSE Study

- **GSE Study.** Requires the Treasury Secretary to conduct a study of and develop recommendations regarding the options for ending the conservatorship of Fannie Mae and Freddie Mac and to report its findings to the Congressional Banking Committees by January 31, 2011.
- Options to be studied include: gradual wind-down and liquidation; privatization; incorporation of functions into a government agency; and dissolution into smaller companies.

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