Davis Polk

Summary of the Restoring American Financial Stability Act of 2009, Introduced by Senator Christopher Dodd (D-CT) November 10, 2009 Discussion Draft

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This summary compares the Restoring American Financial Stability Act of 2009, referred to as the "Dodd bill," with various other legislative proposals, including:

- The Financial Stability Improvement Act, as amended by the House Financial Services Committee through November 6, 2009, or the "House Interim Version";
- The Investor Protection Act, passed by the House Financial Services Committee on November 4, 2009, or the "House Investor Protection bill";
- The Consumer Financial Protection Agency Act, passed by the House Financial Services Committee on October 29, 2009, or the "House CFPA bill";
- The Accountability and Transparency in Rating Agencies Act, passed by the House Financial Services Committee on October 28, 2009, or the "House Rating Agencies bill";
- The Private Fund Investment Advisers Registration Act, passed by the House Financial Services Committee on October 27, 2009, or the "House Private Fund Investment Advisers bill";
- The Derivatives Markets Transparency and Accountability Act, passed by the House Committee on Agriculture on October 21, 2009, or the "Peterson bill";
- The Over-the-Counter Derivatives Markets Act, passed by the House Financial Services Committee on October 15, 2009, or the "Frank OTC bill";
- The Federal Insurance Office Act, introduced by Representative Paul Kanjorski (D-PA) on October 1, 2009, or the "House Insurance bill";
- The Liability for Aiding and Abetting Securities Violations Act, introduced by Senator Arlen Specter (D-PA) on July 30, 2009, or the "Specter bill";
- Treasury Proposals released in the summer of 2009, or the "Treasury proposals"; and
- The Shareholder Bill of Rights Act, introduced by Senator Charles Schumer (D-NY) on May 19, 2009, or the "Schumer bill."

A familiarity with the business issues and legal background of the prior proposals is assumed. The bullets are organized according to the twelve titles of the Dodd bill and summarize the bill's significant points.

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I. Systemic Regulation

- The Dodd bill creates a new agency to develop and impose heightened prudential standards on systemically important firms. As compared to the House Interim Version, the Dodd bill implements many similar regulatory features but uses a different institutional structure.
- **New Independent Agency for Financial Stability ("AFS")**. The newly-created and independent AFS consists of a Chairman appointed by the President with Senate advice and consent; an independent member also appointed by the President with Senate advice and consent, having experience in insurance industry or regulation and 7 other members.
- ***Other Members****:* Treasury Secretary, Federal Reserve Chairman, Financial Institutions Regulatory Administration ("FIRA") Chairman, CFPA Director, SEC Chairman, FDIC Chairman, CFTC Chairman.

> **Word Games: Systemically Important Firms**
>
> The term to describe systemically important firms is not stable. The Obama Administration called them "Tier 1 financial holding companies"; the House has called them "identified financial holding companies" and may soon call them "financial companies subject to stricter standards"; and the Dodd Proposal calls them "specified financial institutions." For a more detailed overview of the terms used in various bills to describe different types of systemically important firms, see Annex A.

- Independent agency status, therefore subject to Administrative Procedure Act, Freedom of Information Act and Sunshine Act, among others.
- **Stricter Standards Applied to Systemically Important Financial Institutions**. The AFS must impose prudential standards, reporting and disclosure requirements that are stricter than those applicable to other financial companies, that increase in stringency with size and complexity of the financial company and that also take into account differences among systemically important firms.
  - Similar to House Interim Version's tiered concept.
  - ***Stricter prudential standards must include:***
    - ***As in the House Interim Version***: A leverage ratio, liquidity requirements, credit concentration, prompt corrective action, and risk management requirements.
  - ***Well managed and well capitalized***. Must be well managed and well capitalized as defined by the AFS for systemically important firms.
    - Similar to House Interim Version.
  - ***New contingent capital requirement***. All systemically important firms will be required to issue contingent capital that converts into equity when prudential standards are not met or when necessary for US financial stability. The contours are to be set by regulation, and a transition period will apply.
    - New from House Interim Version.
  - ***Risk committee***. Board-level risk committees will be required for public companies. For a further discussion, see Section IX.G, "Corporate Governance."
  - ***New disclosure standards possible***. AFS may prescribe new public disclosures by systemically important firms to support market evaluation of risk profile, capital adequacy, and risk management capabilities.
- ***Living will requirements more onerous***. The resolution plan (living will) and credit exposure reports are subject to FIRA and FDIC review for credibility. FIRA

and the FDIC may jointly determine that the resolution plan is not credible, and may require the firm to resubmit the resolution plan with revisions, including any proposed changes in business operations and corporate structure to facilitate implementation of the plan. If a firm fails to resubmit the resolution plan within the time frame established, with such revisions as were required, FIRA and FDIC may:
  - Jointly impose more stringent capital, leverage, and liquidity requirements and restrictions on the growth, activities, and operations.
  - In consultation with the AFS, may direct a systemically important firm to sell assets or operations after a 2-year grace period.
  - Includes no statement, as in the House Interim Version, that the resolution plan has no limiting effect on the receiver.
- ***Additional reporting possible***. AFS can require systemically important firms and their subsidiaries to report on systemic risk relevant information, but must use existing reports and disclosure to the fullest extent possible.
- **Stricter Standards Applied to Regional and Superregional Bank Holding Companies**
  - The AFS is required to establish stricter standards for ***all*** bank holding companies that are not systemically important firms, excluding those with less than $10 billion in total assets, in the areas of risk-based capital, leverage ratio and liquidity.
  - The AFS is required, in setting heightened standards, to take into account differences among bank holding companies, and to establish standards on graduated basis but to ensure that small changes in factors in designating systemically important firms do not result in sharp, discontinuous changes in the standards.
  - The AFS will require those publicly-traded bank holding companies to have a board-level risk committee. See Section IX.G, "Corporate Governance."
- **Stricter Standards for Financial Activities and Practices of Any Financial Company**
  - AFS can issue recommendations to any functional regulator to apply heightened standards and safeguards to financial activities or practices conducted by any financial company.
    - Similar to House Interim Version, but here, no periodic review of previously identified/specified activities or practices.
  - Implementation by functional regulator.
  - Otherwise similar to House Interim Version.
- **Entering the Systemic Risk Regulatory Regime**. The AFS will identify financial companies that are systemically important based on a set of discretionary factors that are familiar from the House Interim Version.
  - Determination only after notice and opportunity for a hearing, with an emergency exception; different from House Interim Version's requirement to inform and opportunity to submit written materials.
  - Registration with the AFS is required within 180 days.
  - AFS to consult with primary financial regulatory agency, if any, before making determination.

Word Games: Financial Companies

For a more detailed overview of the terms used in various bills to describe different types of financial firms, see Annex A.

- **Exiting the Systemic Risk Regulatory Regime**. Even when identification as systemically important is rescinded, firms remain subject to heightened standards until the primary financial regulatory agency determines otherwise.
    - Annual re-assessments are required whereas the House Interim Version is "periodic."
- **Business Consequences of Entering the Systemic Risk Regime**. All systemically important firms would be subject to a new regime, including:
    - ***Asset sales and break-ups***. If AFS determines after notice and hearing and in consultation with FIRA that a systemically important firm's size or scope of activities would pose a threat to the US economy or the firm itself, AFS may, again in consultation with FIRA, require the sale of assets or the termination or restriction of certain activities.
        - Same as in House Interim Version.
    - ***Credit exposure limits***. Credit exposure to any unaffiliated company that exceeds 25% of capital and surplus with AFS authority to lower the percentage or provide an exemption.
        - Same as in House Interim Version.
    - ***Management Interlocks***
        - A systemically important firm would be treated as a bank holding company for the purpose of the Depository Institution Management Interlocks Act, which generally prohibits a bank or bank holding company officer from simultaneously serving as an officer of an unaffiliated depository institution or depository institution holding company.
        - FIRA may not exercise the usual exemptive authority under the Depository Institution Management Interlocks Act to permit service by a management official of a specified US financial company as a management official of any other nonaffiliated specified US financial company except on a temporary basis after a merger, acquisition, or consolidation.
        - House Interim Version would treat systemically important firms as bank holding companies but would not limit the exemptive authority.
    - ***Acquisitions***
        - ***Bank Acquisitions***:
            - Systemically important firms are subject to the limitation on bank acquisitions applicable to bank holding companies.
        - ***Nonbank Acquisitions***:
            - Any acquisition by a systemically important firms of direct or indirect ownership or control of voting shares of any company engaged in nonbanking activities, having total consolidated assets of $10 billion or more, should be authorized in advance by FIRA, except when the acquisition would qualify as a permissible nonbanking acquisition for bank holding companies or as a permissible underwriting, dealing, or securities market-making activity for financial holding companies under the Bank Holding Company Act.

        - No similar limitation in the House Interim Version, other than the $25 billion threshold for approval by the Federal Reserve, which also appears in the Dodd bill.
        - In connection with such authorization, FIRA is required to:
            - Consider the extent to which the proposed acquisition would result in greater or more concentrated risks to global or US financial stability or economy, in addition to the standards provided in the Bank Holding Company Act.
            - Deny the authorization unless the systemically important firm, before and immediately after the proposed acquisition, is and will be well managed and well capitalized.
- ***Examinations of companies that do not control banks***
    - FIRA may directly examine each specified US nonbank financial company and its subsidiaries and any US subsidiaries, branches, or agencies of a specified foreign nonbank financial company, in order to determine the nature of the operation and financial conditions of the company and the risks within the holding company that may pose a threat to its safety and soundness or to the stability of the US financial system.
    - House Interim Version would not give a similar examination authority to the Federal Reserve or the Financial Services Oversight Council.
- ***Enforcement Authority***. Specified US nonbank financial companies and specified foreign nonbank financial companies, and their subsidiaries, are subject to enforcement authority as if such companies were bank holding companies and their subsidiaries were insured depository institutions under the Federal Deposit Insurance Act.
    - In the case of a functionally regulated subsidiary, if its condition, practice or activity does not comply with the regulations or order prescribed by AFS or otherwise pose a threat to US financial stability, FIRA may recommend to the relevant primary financial regulatory agency to initiate a supervisory action or enforcement proceeding.
    - In addition, if FIRA determines that a condition, practice, or activity of a specified foreign financial company does not comply with the systemic regulation provisions or otherwise poses a threat to US financial stability, FIRA may, after notice and opportunity for a hearing, which can be waived in an emergency, order a specified foreign financial company that operates a branch, agency, or subsidiary in the US to terminate the activities of such branch, agency, or subsidiary.
    - House Interim Version would give the Federal Reserve enforcement authority over identified financial holding companies (or their intermediate holding companies) as bank holding companies. Termination authority over foreign financial institutions did not appear in the House Interim Version. There is a narrower termination authority in current law.

- o ***Broad powers with respect to significantly undercapitalized companies and undercapitalized companies that fail to submit/implement capital restoration plans***. FIRA's regulatory tools include requiring recapitalization via sales of shares or acquisition/combination, restricting transactions with affiliates, restricting asset growth, restricting activities, reshuffling management (including notice and hearing for terminated executives) and limiting executive pay, requiring divestiture or other action.
    - Same as under House Interim Version.
- o ***Mandatory bankruptcy petition or resolution***. As under the House Interim Version, critically undercapitalized systemically important firms must petition for bankruptcy (voluntarily or involuntarily) within 90 days of becoming critically undercapitalized.
    - FIRA and the FDIC may also submit a written recommendation leading to FDIC receivership.

- **International Coordination and Convergence**. FIRA, AFS and the Treasury Secretary are required to work with home country supervisors and multilateral organizations, presumably the G-20 and the Financial Stability Board, among others, to ensure that on a global basis there is comprehensive and robust prudential supervision and regulation to all highly leveraged and substantially interconnected financial companies.
- **Commercial Companies/Others Not Previously a Bank Holding Company**. A financial firm that was not previously a bank holding company, *e.g.* a commercial parent, an insurance company, a hedge fund or an asset manager, among others, is treated with more flexibility under the Dodd bill than the House Interim Version.
    - o It will not be regulated as a bank holding company at either the parent or intermediate holding company level, but will be subject to limitations on acquisitions, management interlocks and other restrictions similar to those applicable to a bank holding company as described elsewhere.
    - o Intermediate holding company is not required but:
        - ***May*** be imposed by the AFS for activities that are financial in nature or incidental.
            - Special limits to separate commerce and banking in the House Interim Version such as no cross-marketing, no tying, superstrong 23A and 23B, are not imposed by the Dodd bill but may later be imposed or not by the AFS in its discretion.
        - FIRA can also require a commercial firm, with 15% or more of gross revenues not financial in nature or incidental, that owns or controls more than one insured depository institution to establish an intermediate holding company to hold the insured depository institutions. This applies whether or not the firm is systemically important.
            - Unlike in House Interim Version, not all activities that are financial in nature would have to be conducted out of that intermediate holding company.
- **AFS has power to request information directly from financial firms and request examinations**. The AFS may request production of information from

any agency represented on the AFS board. It may require submission of any reports directly from any "financial company" for assessment purposes, and can request that FIRA conduct an examination if information production alone is insufficient to make this assessment. Wherever possible, the AFS must rely on information already collected by a member agency.

- **AFS Expenses**. For the first 2 years, AFS expenses will be covered by the Federal Reserve; it is then self-funded according to an assessment schedule for systemically important firms to be established by the AFS, taking into account differences between systemically important firms. The Federal Reserve covers any shortfalls.
- **Foreign financial institutions**
  - ***Application to Foreign Institutions***. The application of the prudential standards to foreign financial institutions remains unclear, as it also is in the House Interim Version. The key policy question is the extent to which the intent is to apply US standards and regulation to the foreign parent on an extraterritorial basis, to apply it only to the US operations or the extent to which the idea is to work through the G-20 and the Financial Stability Board to ensure converged standards globally. As a technical drafting matter, whatever the policy resolution, in both the Dodd bill and the House Interim Version key definitional concepts are not yet aligned with either the current legal framework nor do they make clear the intent regarding the scope of extraterritorial application.
  - ***Systemic Determination***. FIRA, AFS and the Treasury Secretary are required to work with home country supervisors and multilateral organizations, presumably the G-20 and the Financial Stability Board, among others, to ensure that on a global basis there is comprehensive and robust prudential supervision and regulation applicable to all highly leveraged and substantially interconnected financial companies. In applying the US standards to foreign financial institutions, they are instructed to take into account the extent to which such companies are subject to standards comparable to those applied to US systemically important firms. As a result, it is unclear whether the systemic determination for a foreign nonbank financial company will take into account global operations or just US and whether it would look to US or global factors. There seems to be a limit that requires substantial operations or assets in the US as well as standards of national treatment, and competitive equality. As a technical matter based on the definitions, it is not clear whether the limit on substantial assets applies to foreign banks that are already bank holding companies. See Annex A.
  - ***Regulatory Discretion on Application***. It appears to be the case that FIRA, or the Federal Reserve in the House Interim Version, would be given the discretion to decide the extent to which heightened prudential standards would apply under the principle that foreign institutions should be treated the same as US institutions, known as national treatment, and competitive equality. How this instruction for regulatory discretion would work with the Dodd bill definitions which appear to have been drafted to include foreign entities and therefore raise the risk of an extraterritorial application is unclear. The House Interim Version, by contrast, seems to

set up a system that looks mainly at the US operating entity for the application of US regulation.

- **Competitive Equality**. The Dodd Bill makes explicit a concern for the competitive equality of US firms by stating that in applying stricter standards to foreign firms, the regulators will take into account whether the foreign firms are subject to standards comparable to US firms.

II. Enhanced Resolution Authority

- **Similar Resolution Authority**. The Dodd bill's resolution authority provisions are similar to those under the House Interim Version. The SEC or FDIC can be the appropriate federal regulatory agency for a failed institution; only the FDIC can be a receiver. A recommendation to invoke resolution authority is to be made by the FIRA board and the FDIC or the SEC; there is no involvement of the Federal Reserve in this decision.
    - Unlike the House Interim Version, there is no mandatory rulemaking with respect to the allowance and disallowance of claims; the permissive rulemaking by the FDIC is to be undertaken in consultation with the AFS.
    - Similar to the House Interim Version, there is no qualified receivership or conservatorship option.
    - Minimum guaranteed recovery provisions are included.
    - One of the mandatory conditions to providing financial assistance in the House Interim Version was that unsecured creditors must bear losses; in the Dodd bill, the requirement is to "not prevent unsecured creditors from bearing losses."
    - No emergency exception for antitrust review.
- **Contingent Capital**. Systemically important firms would be required to maintain a minimum amount of long-term hybrid debt that is convertible to equity when the firm fails to meets its prudential standards and threats to financial stability make conversion necessary.
    - This could effectively slow down a company's demise, providing regulators and the company time to devise alternatives, and obviate the need for the resolution authority to be invoked.
- **Qualified Financial Contracts**. The automatic stay for close-out/netting of QFCs by counterparties or transfers of QFCs to third parties is ***three*** business days following the appointment of the receiver under the Dodd bill; the automatic stay is only ***one*** business day in the House Interim Version, and in the FDIA.
    - This is more protective of the failed company and the receivership, which can decide whether to transfer such QFCs, and less protective of the counterparties, which will not be able to close-out or net until later.
- **Bridge Financial Company Powers**. The bill modifies them somewhat, but not significantly. The FDIC can set up a bridge financial company in anticipation of being appointed receiver; it is also not expressly prohibited from assuming liabilities that count as regulatory capital.
- **Maintains ex-post funding of the Systemic Risk Fund**. Assessments are at a ***higher rate*** on any financial company that received additional payments or credits from the FDIC above the guaranteed minimum recovery (the liquidation amount under bankruptcy).
    - Not clear what the impact of this provision would be; creditors whose claims are transferred to a third party may receive more than the guaranteed minimum recovery, but they are not being paid by the FDIC directly.
- **No open assistance provision in the resolution authority, but also no emergency stabilization fund elsewhere in the bill**. Deliberately closes the possibility of providing assistance to solvent entities prior to receivership.

- Strikes the provisions that would make it clear that a company placed in receivership is not a US agency.
- **Changes to Least Cost Resolution**. Has the same limitation on the systemic risk exception to the least cost resolution requirement in the FDIA as is in the House Interim Version.

III. The Financial Institutions Regulatory Administration – Single Banking Regulator

- **Purpose**. FIRA is established as a new independent agency which will take over the powers of the Federal Reserve with respect to the supervision of bank holding companies and member banks, the OCC with respect to national banks, the OTS with respect to federal thrifts and the FDIC with respect to nonmember banks. FIRA will be the supervisor of any branch, agency, representative office, or commercial lending company of a foreign bank. The Federal Reserve is left with monetary policy and the role of lender of last resort and the FDIC is left with the deposit insurance fund.
- **Organization**
  - ***Board of Directors***
    - FIRA would managed by a board of directors composed of:
      - FDIC Chairman.
      - Federal Reserve Chairman.
      - 3 US citizens appointed for a term of 6 years by the US President, by and with Senate advice and consent.
        - 1 of whom has experience in State bank supervision and will be the Vice Chairman
        - 1 of whom is appointed as FIRA Chairman and will have a term of 5 years.
      - As with most other independent agencies, not more than 3 of the members of the FIRA board may be members of the same political party.
    - Ineligibility for other offices:
      - No FIRA board member may hold stock in any institution subject to regulation by FIRA or may be an officer, director or employee of any such institution, Federal Reserve or Federal Home Loan Bank during the period of service on the FIRA board.
      - A FIRA board member may not hold any office, position or employment in any such institution for 2 years after leaving the FIRA board.
  - ***State Bank Advisory Board***
    - ***Composition***. A State Bank Advisory Board is established within FIRA. Its 5 members would appointed by the FIRA board, from among the State bank commissioners and in consultation with the Conference of the State Banking Supervisors, and serve for 2 years.
    - ***Duties include***:
      - Make recommendations to the Board concerning:
        - Any rules or guidelines of FIRA.
        - Streamlining of regulation and supervision of State-chartered community banks that are well-managed and well-capitalized.
        - Any proposed supervisory, examination or enforcement policies of FIRA.

        - Informing the Board about developments and issues relating to State banks and their supervision.
  - ***Division of Community Bank Supervision***
    - ***Composition****.* A Division of Community Bank Supervision is established within FIRA. The Director of the Division is appointed by the FIRA Chairman and reports directly to him/her.
    - ***Purposes****.* To examine and supervise community banks. A community bank is defined as a small national or State bank or a small Federal or State saving associations, as determined by FIRA.
      - Make recommendations to the FIRA board for standards appropriate to the supervision of community banks.
    - ***Prohibition****.* No member of the FIRA board or other FIRA employee may promote the conversion of a State bank to a national bank, subject to rules issues by the AFS, in consultation with the AFS.
- **Transfer date**. 1 year after the enactment of the Act possibly extended by a further 6 months by the Treasury Secretary after consultations with OCC, OTS, the Federal Reserve, and FDIC. Prior explanations to Congressional committees are required in the event of a delay in transfer and any decision to delay must be taken within 6 months after the Dodd bill becomes law.
- **No New Federal Savings Associations**
  - OTS or FIRA, as the case may be, may not issue any ***new*** charters for Federal savings associations. OTS and FIRA will continue to have authority to examine and regulate federal savings associations as long as any exist. This provision does not, as reported by some, eliminate existing federal savings association charters but is clearly designed to speed their exit from the scene. It is an open question whether a business model that requires that the qualified thrift lender test be met is viable in an era of stricter regulation.
  - ***Branching***. Existing State and Federal saving associations that become a bank within the year following enactment are allowed to continue to operate branches and agencies that were operated or in the process of being established by such saving association on or before the enactment of the Dodd bill.
    - Because thrifts can branch nationwide, and banks can only branch by merger or into states that specifically permit *de novo* branching, thrifts have established branches in states where they may not have been able to do so had they been national banks. This provision allows those former thrifts to retain those otherwise impermissible branches, and to proceed with pending applications.
- **Additional Powers of the FDIC**
  - ***Assessments for Insured Depository Institutions***
    - Insured depository institutions might be barred from the lowest-risk category for deposit insurance assessment solely because of size.
    - Assessments are based on the FDIC assessment rate multiplied by the average total assets of the insured depository institution decreased by its average tangible equity. As a practical matter

this moves towards an asset-based assessment, which is favored by small banks and disfavored by banks or bank holding companies that do not rely heavily on deposits.

- ***Management of the Federal Deposit Insurance Corporation***
  - The Federal Reserve Chairman and the Chairman of FIRA become members of the FDIC board in place of the Comptroller of the Currency and the Director of the Office of Thrift Supervision, respectively. This is similar to the House bill with the addition of the FIRA Chairman.

- **FIRA and Functionally Regulated Subsidiaries**. FIRA, like the Federal Reserve currently, would be required to use pre-existing reports to functional regulators and public information with the added provision that a bank holding company or any subsidiary must promptly comply.
- **Transition Oversight**. The Financial Regulatory Agencies Transition Oversight Commission is created to ensure that FIRA as well as AFS and CFPA have an orderly and organized start up, attract and retain qualified workforces, and establish comprehensive employee training and benefits programs. It oversees the transition of responsibilities and employees and the subsequent administration, management, among other things, of the new agencies and is composed of 5 members appointed by the President, by and with Senate advice and consent.

IV. Regulation of Advisers to Hedge Funds and Others

- **Private Adviser Exemptions Narrowed so that SEC Registration is Required for a Broader Range of Advisers**. The Dodd bill eliminates the intrastate exemption from registration for investment advisers with any private fund client; eliminates the exemption from registration for investment advisers with fewer than 15 clients; and eliminates the CFTC-registered commodities trading advisor exemption where such commodities trading advisor is an investment adviser to a private fund.
  - A **private fund** is defined as any US fund with fewer than 100 investors or investors that are all qualified purchasers (the 3(c)(1) and 3(c)(7) exemptions) if it either is created in the US or has more than 10% of its securities owned by US persons.
  - The House Private Fund Investment Advisers bill's definition of a "private fund" does not require an investment fund to be created in the US or to have 10% or more of its securities owned by US persons in order to be deemed a "private fund."
- **Exemptions**. Registration under the new system would not be required for:
  - ***Foreign Private Advisers***. Investment advisers with no place of business in the US, fewer than 15 US-domiciled or US-resident clients, assets under management attributable to US-domiciled or US-resident clients below $25 million, and who do not generally hold themselves out to the public as an investment adviser or a business development company (nor act as an investment adviser to a registered fund).
    - Removes House Private Fund Investment Advisers bill's reference to clients/assets under management "during preceding 12 months." The House Private Fund Investment Advisers bill uses "in the United States," while the Dodd bill specifies residence or domicile.
  - ***Venture Capital Fund Advisers***. Registration requirements are not triggered by provision of investment advice by an investment adviser to a "venture capital fund," which SEC must define within six months of enactment. The bill provides the exemption from the "registration requirements" of this title with no mention of any reporting obligation.
    - House Private Fund Investment Advisers bill requires SEC to promulgate a rule providing an exemption and directs the SEC to require recordkeeping and reporting obligations.
  - ***Private Equity Fund Advisers***. Registration requirements are not triggered by provision of investment advice by an investment adviser to a "private equity fund," which the SEC must define within six months. This exemption is new.
    - The SEC will require maintenance of records and annual reports to the SEC.
  - ***"Family Offices"*** as defined by the SEC are excluded from definition of "investment adviser." This exemption is new.
  - Removes House Private Fund Investment Advisers bill's additional exemptions for investment advisers to small business investment companies and for small private fund advisers (*i.e.*, assets under management in each fund below $150 million).

- **Minimum Assets for SEC Adviser Registration**. State-regulated investment advisers may not register with the SEC unless they have assets under management of $100 million or more.
    - Similar to a provision in the House Investor Protection bill. The House Investor Protection bill language is unclear, but appears to intend state registration in lieu of SEC registration for investment advisers that are subject to state regulation and have greater than $25 million but less than $100 million in assets under management.
    - The House Private Fund Investment Advisers bill includes an exemption from SEC registration for small private fund advisers (*i.e.*, assets under management in each fund below $150 million).
- **Keeping Records and Reports of Private Funds**. Registered investment advisers must maintain records, file reports with the SEC, and provide or make them available to the AFS. Like the House Private Fund Investment Advisers bill, records are also available to the SEC on request; the House Private Fund Investment Advisers bill makes information available to the Federal Reserve or any other agency the SEC identifies as having systemic risk responsibility.
    - Records and reports of private funds provided to the fund's registered investment adviser are deemed to be records of the adviser.
        - Broader than the House Private Fund Investment Advisers bill, which deems records and reports of a private fund to which a registered investment adviser provides investment advice that are "maintained or filed by [a registered] investment adviser" to be those of the investment adviser.
    - Registered investment advisers must maintain and file information regarding private funds advised by the registered investment adviser as necessary "for the protection of investors, or for the assessment of systemic risk" by the AFS.
        - Substantially similar to the House Private Fund Investment Advisers bill.
    - The following are "required to be filed" (House Private Fund Investment Advisers bill reads "required to be maintained or filed with the Commission"),
        - Amount of assets under management; counterparty exposure; trading and investment positions; trading practices.
            - Same as House Private Fund Investment Advisers bill.
        - Valuation methodologies of funds; types of assets held; side arrangements/letters.
            - New.
        - Use of leverage (House Private Fund Investment Advisers bill explicitly includes off-balance sheet leverage); other information deemed necessary by the SEC (similar to House Private Fund Investment Advisers bill, but SEC must consult with the AFS instead of the Federal Reserve).
        - House Private Fund Investment Advisers bill includes an "Optional Information" section for SEC to require reporting of additional information as the SEC deems necessary and specifying that SEC may set different reporting requirements based on differences among private funds.

- Maintenance of records for period to be prescribed by SEC.
  - Same as House Private Fund Investment Advisers bill.
- The SEC must conduct periodic examinations of records, and special examinations may be conducted at any time.
  - House Private Fund Investment Advisers bill requires records to be available for any periodic or special inspections that the SEC may prescribe.
- Annual report by SEC to Congress on use of collected data to protect investors and integrity of markets.
  - New.
- Joint Disclosure Rules by SEC and CFTC for investment advisers registered under both Advisers Act and Commodity Exchange Act.
  - Same as House Private Fund Investment Advisers bill.
- After consultation with AFS, there will be a six month deadline for SEC/CFTC joint rules on form and content of reports.
  - Substantially similar to House Private Fund Investment Advisers bill (which required consultation with Federal Reserve).

- **Information Sharing and Confidentiality**. The Dodd bill allows sharing of any information filed with or received by the SEC that the AFS considers necessary for assessing systemic risk. Such shared information to be kept confidential.
  - Similar to House Private Fund Investment Advisers bill.
  - SEC not to be compelled to disclose supervisory reports ("any report or information contained therein required to be filed") or contents filed hereunder, except:
    - To Congress with confidentiality agreement.
      - New.
    - To Federal department/agency or self-regulatory organization ("SRO") within its jurisdiction.
      - Same as House Interim Version.
    - By court order in action brought by US or SEC.
      - Same as House Interim Version.
  - House Private Fund Investment Advisers bill applies to "any report or information contained therein required to be filed," and also includes a requirement for disclosure of certain private fund information to investors, prospective investors, counterparties, and creditors, as prescribed by the SEC, for investor protection or systemic risk assessment.
  - Information provided is explicitly carved out from FOIA disclosure by noting that the information will be considered "matters that are . . . specifically exempted from disclosure by statute" as provided for in an exemption included in FOIA.
    - Same as House Private Fund Investment Advisers bill.
- **SEC Rulemaking Clarifications**. The SEC is given authority to:
  - Define "technical, trade, and other terms" used in the Advisers Act.
    - Same as House Private Fund Investment Advisers bill.
  - Classify persons and matters and prescribe different requirements for different classes.
    - House Private Fund Investment Advisers bill includes minimum criteria required to be the basis of a classification of persons or matters—size, scope, business model, etc.

    - Ascribe different meanings to terms, including “client,” used in different sections.
        - Broader than the House Private Fund Investment Advisers bill, which specifies that “client” may not be defined to include an investor in a private fund managed by an investment adviser, where such private fund has entered into an advisory contract with such investment adviser.
- **Custody of Client Assets**. The SEC is to issue rules to require registered investment advisers to use an independent custodian to hold client assets.
    - The House Investor Protection bill requires SEC to adopt a rule making it unlawful for registered investment advisers to have custody of more than $10 million of client funds/securities unless with a qualified custodian.
- **Accredited Investor Standard to be Adjusted for Inflation**. The SEC is required to increase the financial thresholds applicable to an accredited investor who is a natural person in light of price inflation and to adjust at least once every five years. This would affect whether an individual can purchase securities in a private placement under the Securities Act. The House Private Fund Investment Advisers bill reflected an inflation adjustment for the qualified client standard under the Advisers Act, which would determine whether a client can be charged a performance-based fee.
- **GAO Study**. The House Private Fund Investment Advisers bill requires a Comptroller General study of costs on industry members and investors due to the new registration and reporting requirements, with a report to Congress in two years. In the Dodd bill, the Comptroller General is tasked with reports on the appropriateness of criteria for accredited investor status/eligibility to invest in hedge funds (report to Congress in one year); the feasibility of forming an SRO to oversee hedge funds, private equity funds and venture capital funds (report to Congress in one year); and the state of short selling in the market (report to Congress in two years).
- **SEC Regulation of Investment Holding Companies**. Like the House Private Fund Investment Advisers bill, the Dodd bill eliminates this possibility which had been, as a practical matter, no longer relevant.

Davis Polk

V. Insurance

- Similar in most respects to the House Insurance bill, the Dodd bill would create an Office of Insurance ("ONI") within Treasury with certain limited powers. In addition, the Dodd 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

- **Establishment**. The Dodd bill would create an Office of National Insurance within Treasury. Although not an optional federal regulator for which some continue to lobby, ONI would have real, though limited, powers, and could portend increased federal involvement in the industry.
- **Functions and powers**. In addition to any other assigned duties, ONI would monitor the insurance industry, recommend to the AFS any insurers that should be treated as systemically important, assist in administering the Terrorism Insurance Program, represent the US in overseas forums such as 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 to be established, includes the authority to issue subpoenas, which was not provided for in the House Insurance bill, but which was included in the Obama Administration's proposed legislation from July of this year. 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.
    - The Dodd bill contains a new savings provision specifying that the Dodd bill will not be construed to affect development of US trade policy, as well as a new requirement that the Treasury Secretary consult with US Trade Representative before concluding any international insurance agreement. This may be in response to jurisdictional concerns that have temporarily delayed the markup of the House Insurance bill.
- **Preemption**. The Dodd bill grants the ONI power to preempt any state insurance regulation that results in less favorable treatment of a non-US insurer as compared to a US insurer admitted in the state and is inconsistent with an international agreement on prudential measures.
    - The Dodd bill includes a requirement, not present in the House Insurance bill, that ONI notify and consult with the relevant state regulator prior to making preemption determination.
- **Report**. The Dodd bill also has provision, not included in the House Insurance bill, that requires the ONI, within 18 months, to submit a report to Congress on improving US 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; and
    - ability of federal regulation to provide robust consumer protection.

B. State-Based Insurance Reform

- **Background**. The Nonadmitted and Reinsurance Reform Act, included in the Dodd 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 Dodd 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, the Dodd bill would:
    - Prohibit states from imposing eligibility requirements on nonadmitted insurers domiciled in a US 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 US and included on an NAIC list.
- The Dodd 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 Dodd bill eliminates state requirements that surplus lines brokers undertake diligence searches to determine whether coverage can be obtained from admitted insurers.
    - A "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 Dodd 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.

- The Dodd bill 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.

VI. Bank Holding Company Act Improvements

- Similar to the House Interim Version, the Dodd bill expands regulation over banks, thrifts, thrift holding companies and bank holding companies.
- **Capital and Management Requirements for Financial Holding Companies**. In addition to meeting the well-capitalized and well-managed requirements at the subsidiary depository institution level, bank holding companies must be well capitalized and well managed at the holding company level as well to qualify for financial holding company status.
  - Same as in House Interim Version.
- **Capital and Management Requirements for Interstate 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.
  - Same as in House Interim Version.
- **Additional Restrictions on Activities**. Enhanced restrictions on bank transactions with affiliates, lending limits applicable to credit exposure on derivative transactions and other transactions, the application of national lending limits to all insured depository institutions, lending limits to insiders, and limitations on purchases of assets from insiders.
  - Same as in House Interim Version.
- **Restrictions on Conversions of Troubled Banks**. Conversion of national banking associations into a State bank or State savings association, and vice versa, are prohibited 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. Under the same conditions, a Federal savings association may not convert to a national or State bank or State savings association.
  - Same as in House Interim Version.
- ***De novo* branching into states**. The Dodd bill would amend the state "opt-in" election to permit interstate branching by national banks and state nonmember banks through *de novo* branches. 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.
  - Limits a state's ability to restrict branching by out-of-state banks.
  - New.
- **Regulations regarding capital levels of holding companies**
  - FIRA will be authorized to issue regulations relating to the capital levels of bank holding companies and to the capital requirements for savings and loan holding companies, respectively.
    - Substantively the same as the House Interim Version.
  - ***Source of Strength***. Any company that owns or controls an insured depository institution might be required to serve as source of financial strength for such institution and to submit reports to assess the ability of the holding company to comply with the requirement.
  - ***Intermediate Holding Company***. Commercial firms that directly own or control more than one insured depository institutions might also be

required, in order to provide for the enhanced supervision of the insured depository institutions, to establish an intermediate holding company to hold them, whether or not the insured depository institution is systemically important.

- **Limitations to Acquisitions and Activities**
  - ***Bank Acquisitions***. In connection with applications for acquisitions of bank shares and assets under the Bank Holding Company Act, FIRA must take into consideration the extent to which the proposed acquisition, merger or consolidation would result in greater or more concentrated risks to the stability of US banking and financial system, in addition to the other factors to be considered under the statute.
  - ***Nonbank Acquisitions***. In connection with applications for nonbanking acquisitions and engagement in nonbanking activities under the Bank Holding Company Act, FIRA is required to consider the risks to the stability of US banking and financial system as one of the possible adverse effects of the transaction which should be outweighed by the benefits produced to the public.
  - ***Activities that are financial in nature***. Financial holding companies are not allowed, without FIRA prior approval, to acquire any company engaged in or to commence any activity determined to be financial in nature or incidental to such financial activity if the total assets to be acquired in the transaction exceed $25 billion.
  - ***Merger Transactions***. In connection with applications for merger transactions under the Federal Deposit Insurance Act, the risks to the stability of the US banking and financial system created by the transaction must be taken into consideration, in addition to the other factors to be considered already under the statute.
  - Above limitations on acquisitions and activities same as the House Interim Version.
- **GAO Study on Bank Holding Company Act Grandfather Exemptions**. The Dodd bill calls for a study by the GAO on whether it would be appropriate to continue the various Bank Holding Company Act grandfather exemptions.
- **Moratorium on ILCs, Trust Banks, and Credit Card Banks Getting Deposit Insurance**. The Dodd bill puts into the statute the regulatory policy of not approving any new applications for deposit insurance from ILCs, trust banks and credit card banks. Further limits change in control of industrial banks, credit card banks or trust banks if it would result in control by a commercial firm.

VII. Regulation of OTC Derivatives Markets

- **Overview:** The Dodd bill's regulation of the over-the-counter ("OTC") derivatives markets is largely based on the Treasury proposal, the Frank OTC bill and the Peterson bill.
- **Scope:** The Dodd bill creates a strong presumption of clearing of all swaps subject to the ability of the regulatory agencies to create rules to exempt swaps from clearing and exchange trading under limited circumstances.

Definitional and Jurisdictional Matters

- The definitions of and allocation of jurisdictional authority as between the SEC and the CFTC with respect to swaps, security-based swaps and mixed swaps are largely unchanged from the Frank OTC bill. The joint rulemaking required of the SEC and CFTC is also materially unchanged.
  - New exclusion from the definition of "swap" and, thereby, "security-based swap" for physically-settled sales of securities for deferred shipment or delivery. It is unclear what, if anything, this adds as there is already an exclusion for the purchase or sale of one or more securities on a fixed basis.
- **Security-Based Swaps and the Securities Act and Exchange Act:** Security-based swaps added to the definition of "security" in the Securities Act and the Exchange Act.
  - ***Registration:***
    - Distributions of security-based swaps must be registered under the Securities Act.
    - Sales of security-based swaps to non-eligible contract participants ("non-ECPs") are not eligible for exemption under Sections 3 or 4 of the Securities Act, though the SEC is provided exemptive power from this requirement.
  - As in the Frank OTC bill, an offer or sale of a security-based swap by or on behalf of the issuer of the underlying security, its affiliate or underwriter is considered an offer or sale of the underlying security.
- **Exemptive Authority:** The Dodd bill explicitly deprives the SEC and CFTC of exemptive authority from its swap and security-based swap provisions except where specifically authorized.
- **Exchange Act Beneficial Ownership Provisions:**
  - Like the Frank OTC bill, the Dodd bill adds positions underlying security-based swaps or other derivatives determined by the SEC to the beneficial ownership reporting requirements of Section 13 of the Exchange Act and the short-swing profit rule of Section 16 of the Exchange Act.
  - Unlike the Frank OTC bill, but like the Peterson bill, the Dodd bill contains no requirement that for the SEC to deem an owner of a security-based swap to be the beneficial owner of the underlying security, the security-based swap must have "incidents of ownership comparable to direct ownership of the equity security."

Clearing Requirement

- **General Rule:** All swaps and security-based swaps must be cleared, unless an exemption exists.

- **Exemptions from the Clearing Requirement:**
  - The CFTC and SEC ***may*** exempt a swap/security-based swap from clearing if:
    - The swap/security-based swap is not accepted for clearing by a derivatives clearing organization ("DCO")/clearing agency; OR
    - One party to the contract is not a dealer or major swap/security-based swap participant (each defined below) and that party does not meet the eligibility requirement of a DCO/clearing agency.
  - In order to grant one of the above exemptions, the CFTC/SEC needs to consult with and provide notice to the other main regulator (SEC/CFTC) and to the AFS. Either of these other two agencies can veto a proposed exemption if it determines that it is not "necessary and appropriate for the reduction of systemic risk and in the public interest."
  - Even if a swap/security-based swap is exempted under these rules, a counterparty to that contract can request that it be cleared. In such case, the contract must be cleared so long as it is accepted for clearing by a DCO/clearing agency.
- **Products Accepted for Clearing:**
  - ***DCO/Clearing Agency Rules*****:** For a group, category, type or class of swaps/security-based swaps to be cleared by a DCO/clearing agency, the CFTC/SEC must approve it for clearing. The CFTC/SEC must make a DCO/clearing agency request for clearing public and must approve it if it is consistent with Section 5b(c)(2) of the Commodity Exchange Act or Section 17A of the Exchange Act, respectively. The CFTC/SEC is required to adopt rules for such a submission by a DCO/clearing agency.
    - Like the Treasury proposal, core principles for DCOs/clearing agencies, among other things, establish minimum financial resources and require daily measurement of credit exposures and mandate risk-based margin requirements to limit exposure to losses from defaults
  - ***SEC/CFTC Joint Rules*****:** The SEC/CFTC must jointly promulgate rules identifying swaps/security-based swaps or any group, category, type or class of swaps/security-based swaps that, using a list of enumerated factors, they "deem should be accepted for clearing."
    - Query whether "deem[ing]" that a product "should be accepted for clearing" requires clearing agencies/DCOs to accept it for clearing. While the language of the statute is unclear, the title of the sub-subsection ("Swaps Required to be Accepted for Clearing") seems to imply this is the case.
    - Query whether such "deem[ing]" removes the ability of the SEC/CFTC to exempt the product from the clearing requirement under the exemptions above.
  - ***SEC and CFTC Individual Rules*****:** The SEC and CFTC may each "separately designate a particular swap[/security-based swap] or class of swaps[/security-based swaps] subject to the clearing requirement" using the same list of enumerated factors used to create the joint rules.
    - The clearing requirement referred to in this provision is the general requirement that all swaps/security-based swaps must be

cleared unless an exemption applies. It is therefore unclear what, if anything, this provision adds.

- **Stay of Clearing Requirement:** The CFTC/SEC can stay the clearing requirement of a swap/security-based swap or group, category, type or class of swaps/security-based swaps that it has approved for listing upon request of a counterparty or on its own, and must then determine within 90 days (extendable with agreement of the DCO/clearing agency) whether the product does or does not need to be cleared. A product that the CFTC/SEC determines does not need to be cleared is still allowed to be cleared. The CFTC/SEC is required to adopt rules related to review of products it has accepted for clearing by a DCO/clearing agency.
    - A determination that a product does not need to be cleared under such a review cannot be vetoed by the other primary agency or the AFS, thereby allowing the SEC/CFTC to unilaterally exempt a product from clearing.
    - In addition, a determination that a product does not need be cleared under such a review has no attached conditions (i.e., unlike exemptions, it does not require that i) no clearing agency/DCO accepts the swap for clearing or that ii) one of the parties is not a dealer or a major swap/security-based swap participant ("MSP") and does not meet a clearing agency/DCO's eligibility requirements). The determination that a product does not need to be cleared can be granted for any reason.
- **Implications of Exemption Regime:** The Dodd bill's regime for exemptions from the clearing requirement leaves open a number of questions, both in terms of the meaning of the drafting and the results of the wide discretion given to the SEC, CFTC and AFS.
    - Query whether it is illegal to engage in swaps/security-based swaps that are not exempted from the clearing requirement, but are not accepted for clearing by any DCO/clearing agency.
    - If the SEC, CFTC and AFS all agree that it is "necessary or appropriate in the public interest," all swaps/security-based swaps could be exempted from the clearing requirement.
- **DCO/Clearing Agency Rules:** DCOs/clearing agencies' rules must:
    - Treat as fungible, and allow for the offset of, swaps/security-based swaps with the same terms; and
    - Require "nondiscriminatory clearing" of swaps/security-based swaps executed on contract markets/national exchanges or alternative swap execution facilities.
- **Reporting:** If a swap/security-based swap is not accepted for clearing, both parties must report it to a repository or, if none will accept it, to the CFTC/SEC.
- The Dodd bill allows the CFTC and the SEC to adopt and interpret rules to prevent evasion of the clearing and exchange trading requirements.
- **Transition period:** The CFTC and SEC must promulgate rules that give
    - 180 days to report swaps/security-based swaps entered into before the Dodd bill, unless provided differently by rule.
    - 90 days to report swaps/security-based swaps entered into on or after the date of the Dodd bill, unless provided differently by rule.
    - There does not appear to be any limitation on these transition requirements for matured swaps or security-based swaps.

Exchange Trading Requirements:

- If a swap/security-based swap must be cleared (i.e., it is not subject to a clearing exemption as described above), it also must be executed on a contract market/exchange or alternative swap execution facility, if one accepts it for trading.
- Any contracts with non-ECPs must be exchange-traded.

Regulation of Dealers and Major Swap/Security-Based Swap Participants

- **Dealer Definition:** The Dodd bill defines a "dealer" as a person "engaged in business of buying and selling swaps for [its] own account" as part of a "regular business."
- **Major Participant Definition:** The Dodd bill defines a "major swap participant" or a "major security-based swap participant" as a person who is not a swap/security-based swap dealer and "whose outstanding swaps create net counterparty credit exposures (current or potential future exposures) to other market participants that would expose those other market participants to significant credit losses in the event of the person's default."
  - This definition provides ***no hedging exemption.***
  - Since the "significant credit losses" test is measured with respect to "other market participants" (and not on a systemic level) and takes account of "potential future exposures," it could be very broadly applied.
- **Audit Trails:** The Dodd bill requires dealers and MSPs to maintain complete audit trails, but allows swap and security-based swap repositories to satisfy this audit trail requirement.
- **Business Conduct Standards**
  - The Dodd bill removes the Frank OTC bill's provision that would authorize the SEC and CFTC to adopt standards to limit the extent to which a dealer or MSP could conduct business with clearing and exchange entities in which they have a material debt or equity investment.
  - ***Disclosure requirements***
    - The Dodd bill removes the Frank OTC bill's requirement that the SEC/CFTC adopt business conduct requirements that the dealer or MSP disclose, upon the counterparty's request, daily mark of the clearinghouse for cleared swaps or of the dealer or MSP for non-cleared swaps.
    - The Dodd bill requires disclosure of fees or other remuneration that a dealer or MSP expects to receive. This could be interpreted to require disclosure of P&L with respect to particular transactions.
  - ***Fair Dealing and Good Faith***
    - The Dodd bill introduces new requirements "to communicate in a fair and balanced manner based on principles of fair dealing and good faith" and related to independent representation for ECPs.
  - ***Responsibilities with Respect to Certain Governmental ECPs.***
    - See discussion below under "ECPs."

Capital and Margin Requirements on Dealers and MSPs

- **General**
  - Under the Dodd bill, FIRA (in consultation with the SEC and CFTC) would set capital and initial and variation margin requirements for dealers and

MSPs that are banks, to "help ensure the safety and soundness of the [dealer or MSP]" while the SEC and CFTC (in consultation with FIRA) would jointly prescribe capital and initial and variation margin requirements for dealers and MSPs that are not banks.

- **Capital requirements:**
  - FIRA must set capital levels for dealers and MSPs that are banks that are
    - Greater than 0 for cleared swaps and
    - "Substantially higher" for non-cleared swaps.
  - The SEC and CFTC's required capital levels for non-bank dealers and MSPs must be as strict or stricter as FIRA's requirements for banks.
  - FIRA's required capital levels for dealers and MSPs that are bank holding companies must be as strict or stricter than its requirements for banks generally.
  - The Dodd bill clarifies that its capital requirements do not limit the CFTC's or SEC's authority to set stricter financial responsibility rules for futures commission merchants ("FCMs"), introducing brokers, brokers or dealers as appropriate.
  - The Dodd bill removes the Frank OTC bill's exemption for capital requirements on swaps or security-based swaps to which one party is not a dealer or MSP when the swap is entered into within 90 days of the effective date of the capital requirements.
- **Margin requirements:**
  - FIRA must set initial and variation margin levels for bank dealers and MSPs on non-cleared swaps.
  - FIRA may exempt a dealer or MSP under its primary jurisdiction from margin requirements for transactions in which one of the counterparties:
    - i) Is not a dealer or MSP;
    - ii) Is using the swap as part of an effective hedge under GAAP rules; and
    - iii) Is "predominantly engaged in activities that are not financial in nature" under Section 4(k) of the Bank Holding Company Act. Such activities would include a broad range of lending, advisory, investment, custodial, underwriting, insurance and other activities.
    - Before exempting a dealer or MSP from margin requirements under this rule, FIRA must first consult with the SEC, CFTC and the AFS. Each of these entities can veto such an exemption in the same way as they can veto exemptions to the clearing requirement.
  - The margin levels for non-bank dealers and MSPs must be as strict or stricter as the levels set by FIRA for banks.
    - The SEC and CFTC are provided the same exemptive authority and conditions for use of that authority as is FIRA for banks.
  - FIRA, the SEC and the CFTC may allow for use of non-cash collateral, if consistent with "preserving the financial integrity of markets trading swaps" and "preventing systemic risk."
  - Any party to a swap that is exempt from margin requirements can request margin, in which case the exemption shall not apply.

- The CFTC is allowed to dictate required levels of margin for registered entities if the entity will not do so on its own, subject to certain requests of the CFTC to the registered entity.
- **Segregation of collateral**
    - ***Cleared Swaps/Security-Based Swaps:*** For cleared swaps and security-based swaps, the dealers, FCMs, DCOs and clearing agencies must segregate, and use for the benefit of the counterparty, all funds or other property held to "margin, guarantee or secure" the obligations of the counterparty pursuant to rules set by the CFTC/SEC for non-banks and by FIRA for banks.
    - ***Non-Cleared Swaps/Security-Based Swaps:*** For non-cleared swaps and security-based swaps, at the request of a counterparty a dealer must segregate and keep funds in a designated segregated account at an independent (an undefined term, unlike in the Frank OTC bill) third-party custodian under rules set by the SEC/CFTC for non-banks, including DCOs and clearing agencies, or by FIRA for banks. The dealer is allowed to invest segregated funds and property and allocate gains or losses as permitted under SEC, CFTC and FIRA rules and regulations, except that (in a new provision) investments may be made only in types of permitted investments permitted by the SEC, CFTC or FIRA.

Eligible Contract Participants

- Dodd bill introduces new limitations on ECPs:
    - Corporations, partnerships, proprietorships, organization, trusts and other entities must now have (a) "total net assets" in excess of $10 million or (b) total net assets in excess of $5 million and be entering into the swap in the course of its business or to manage a business risk.
    - Governmental entities are not included in the definition of ECPs unless they own and invest on a discretionary basis $50 million or more not including the proceeds of municipal securities.
    - For natural persons, the test for ECP eligibility is changed from an amount of assets to "an amount owned and invested on a discretionary basis" (i.e., $10 million, or $5 million and entering into the swap to manage certain risks).
- New business conduct requirements for dealers and MSPs that, when dealing with governmental entities, they must have a "reasonable basis" to believe that the governmental entity has an independent representative that:
    - has sufficient knowledge to evaluate the transaction and risks;
    - is not subject to a statutory disqualification;
    - is independent of the dealer or MSP;
    - undertakes to act in best interests of the governmental entity;
    - makes appropriate disclosures; and
    - will make representations to the governmental entity regarding the fair pricing and appropriateness of the transaction.

Other Entities

- **Swap repositories**
    - Definition adds persons who calculate, process or prepare information with respect to positions in swaps or security-based swaps. Unlike the

Frank OTC bill, the Dodd bill does not specify that these are the swaps or security-based swaps of third parties.
    - Registration for swap repositories appears to be optional under the Dodd bill.
    - The CFTC and SEC can exempt swap repositories subject to comparable, comprehensive supervision or regulation by governmental authorities, including foreign home country authorities.
    - The Dodd bill leaves other standards, data collection rules and duties related to swap repositories materially unchanged from the Frank OTC bill.
- **Exchanges, Contract Markets and Alternative Swap Execution Facilities**
    - Unlike the Frank OTC bill, the Dodd bill contains no ownership limitation on dealers/MSPs or restrictions on directors (i.e., the Lynch Amendment to the Frank OTC bill).
- **Alternative Swap Execution Facilities ("ASEFs")**
    - The Dodd bill does not define "alternative swap execution facility." As a result, it is unclear whether the enumerated examples (including confirmation matching services) of ASEFs in the Peterson bill would be included.
    - ASEFs must set position limits or position accountability requirements for contracts "where necessary and appropriate" that are meant to stop market manipulation and congestion
        - Position limits on contracts already subject to SEC/CFTC position limits can be no higher than those SEC/CFTC position limits.

Extraterritoriality

- **No exemptive authority:** The Dodd bill provides the CFTC and SEC no general exemptive authority for comparable, comprehensive supervision by another governmental entity.
- **No authority to ban access:** Unlike the Frank OTC bill, the Dodd bill provides the CFTC and SEC with no authority to ban access for swap/security-based swap market participants from countries whose regulation of swaps "undermine the stability of the US financial system."
- **Consultation with Foreign Regulators:** The Dodd bill requires the SEC, CFTC, FIRA, AFS and Treasury to consult and coordinate with foreign regulators on standards and regulation related to derivatives.
    - The Dodd bill allows the US to agree to information sharing arrangements.

Position Limits and Large Swap/Security-Based Swap Trader Reporting

- **Swaps:** The Dodd bill leaves largely unchanged the general ability of the CFTC to set position limits on swaps that "perform or affect a significant price discovery function."
- The Dodd bill broadens the large swap trader reporting requirements of the Frank OTC bill by making them applicable to all swaps, not only those that "affect[] a significant price discovery function with respect to regulated markets."
- **Security-Based Swaps:** The Dodd bill largely reinstates the ability of the SEC to set position limits on security-based swaps. Most importantly, it allows the SEC to set position limits on the aggregate number or amounts of positions in ***securities listed on a national securities exchange or security-based swaps***

that "affect a significant price discovery function with respect to regulated markets."

- The SEC can direct SROs to adopt position limits on security-based swaps and the underlying securities for its members and persons for whom its members transact in the security-based swap or security.
- The SEC must set position levels for security-based swaps above which large security-based swap traders must provide certain reports and keep certain books and records.

Other Provisions

- **Enforcement Authority:** The Dodd bill leaves the Frank OTC bill's SEC and CFTC enforcement authority provisions largely unchanged.
- **Repeal of Sections 408 and 409 of FDICIA.** Sections 408 or 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") are repealed. These provisions allow a clearing organization to operate a multilateral clearing organization for OTC derivatives instruments if, among other alternatives, it is supervised by a foreign financial regulator that the Comptroller of the Currency, the Federal Reserve, the FDIC, SEC or CFTC determines satisfies appropriate standards. In his August 17, 2009 letter, Chairman Gensler pointed out that these provisions are not necessary in light of the requirement for clearing organizations to register with US regulators and that they could lead to market participants seeking to avoid the new clearing framework by trying to claim that their transactions fell under these FDICIA provisions.
- **State Law Preemption:** The Dodd bill provides no material changes to the Frank OTC bill's state law preemption provisions.
- **Abusive Swaps/Security-Based Swaps:** Unlike the Frank OTC bill, the Dodd bill does not provide the SEC and CFTC with the ability to produce reports on abusive swaps and security-based swaps.
- **Cooperation Between SEC/CFTC:** The Dodd bill implements many of the SEC/CFTC cooperation provisions in the SEC/CFTC Joint Report on harmonization, including creation of a Joint Advisory Committee, joint training and detailing of staff between agencies.
- **Reports by institutional investment managers:** The Dodd bill amends Section 13(f) of the Exchange Act to require reporting by institutional investment managers who hold an amount of derivative securities determined by the SEC. The provision does not require a report of the amount of such derivative securities held. It seems that the SEC may otherwise determine that holding of the derivatives may be deemed ownership of the underlying security.
- **Studies and Reports:** The Dodd bill requires a study and report on implementation of the bill.
    - ***No study:*** Unlike the Frank OTC bill, the Dodd bill does not require study of a single derivatives regulator or of algorithmic descriptions for derivatives.
- **Government Assistance Provisions Removed:** The Dodd bill removes the section of the Frank OTC bill prohibiting government assistance for DCOs. Under the Peterson bill, a provision prohibiting government assistance for clearing agencies was also included.

VIII. Supervision of Payment, Clearance and Settlement

- Broadly similar to the House Interim Version except that access to the Federal Reserve's discount window for systemically important payment, clearing and settlement companies which had been in the Treasury proposal and dropped in the House Interim Version reappears in the Dodd bill.
- See Section XII, "Federal Reserve System Provisions."

IX. Miscellaneous Securities Provisions

A. Increasing Investor Protection

- The Dodd bill has broader investor protection provisions than the corresponding sections of the House Investor Protection bill, including a requirement that most broker-dealers register as investment advisers and a revision to the SRO rule filing process.
- **Regulation of Broker-Dealers as Investment Advisers**
  - ***Requires most broker-dealers to register as investment advisers***. Strikes the exemption for "any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor."
    - Most broker-dealers, including many "self-directed" broker-dealers, will be investment advisers.
      - Broker-dealers normally advise others "as to the value of securities or as to the advisability of investing in, purchasing or selling securities or issues" or "promulgate[] analyses or reports."
    - ***Application of the Advisers Act is not limited to broker-dealers that are providing personalized investment advice about securities to retail customers.***
  - ***Subjects broker-dealers to a fiduciary duty.***
    - Broker-dealers will be subject to a fiduciary duty in their dealings with customers under Section 206 of the Advisers Act.
      - Broker-dealers will be subject to the principal trading restrictions of Section 206(3), unless the SEC uses new rulemaking authority to exempt them.
        - An exemption must be based on a determination that the investment adviser provides "adequate protection" against conflicts of interest or principal transactions that are not in the best interests of investors.
        - "Adequate protection" not defined.
      - As a concession to the broker-dealer business, investment advisers may enter into advisory relationships providing for payment of asset management fee or commission.
    - Section 206 is extended to prohibit transactions where the investment adviser "[fails] to disclose to any client or prospective client any material limitation on the range of investment products about which the investment advisor gives advice."
  - ***Subjects broker-dealers to all other investment adviser requirements.***
    - These include the disclosure, contractual, recordkeeping and administrative oversight provisions.
  - Much broader than the corresponding fiduciary duty standard for broker-dealers and investment advisers set forth in the House Investor Protection Act.

- **Filing Procedures for SROs**. Provides for SRO rule proposals to go into effect automatically if SEC does not act within statutory deadlines. Time periods begin as of SRO website publication, not SEC acceptance of filing.
  - The SEC must start disapproval process to toll the rule's effectiveness, rather than just to start the notice and comment process.
  - Market data fees go into effect immediately without notice and comment.
- **Investor Advisory Committee**. Establishes an Investor Advisory Committee within the SEC to advise and consult with SEC on regulatory priorities, specific regulations, and initiatives to protect investors.
  - Members of the Committee include the newly created Investor Advocate, a representative of state securities commissions and 13-23 individuals. Members have terms of 5 years, with no more than 2 terms.
  - Committee must meet at least twice annually, but need not produce a formal report. SEC must review any Committee findings and issue public statement assessing Committee recommendations, disclosing any actions taken.
- **Office of the Investor Advocate**. Establishes an Office of Investor Advocate within the SEC, reporting directly to the Commission.
  - The Investor Advocate can recommend legislation and rule changes, and changes in SEC administration and personnel. Overlaps with the House Investor Protection bill's requirement for the SEC to appoint an ombudsman.
  - Annual reports on objectives of Investor Advocate for the following fiscal year and reports on activities of the preceding year.
- **Studies**
  - Requires SEC study of financial literacy among mutual fund investors.
  - Requires GAO study of mutual fund advertising practices.
  - Requires GAO study on state of short selling in the stock market, with particular attention to the impact of recent rule changes and incidence of failure to deliver shares sold short.
- **Consumer testing**. Clarifies SEC authority to engage in consumer testing.
- **Investment company share disclosure**. Clarifies SEC authority to require investor disclosures before purchase of investment company shares.

B. Increasing Regulatory Enforcement and Remedies

- **SEC authority to restrict mandatory pre-dispute arbitration**. Requires the SEC to consider prohibiting or limiting the use of mandatory arbitration pre-dispute agreements between broker-dealers and investment advisers.
  - In contrast, the House Investor Protection bill provides the SEC with authority to consider such a rule, but does not mandate consideration.
- **Extending SEC's aiding and abetting authority**. With respect to the Securities Act and the Investment Company Act, extends the SEC's aiding and abetting enforcement authority. With respect to the Advisers Act, clarifies the SEC's aiding and abetting enforcement authority.
  - Clarifies that SEC authority to pursue aiders and abettors would extend to ***reckless, as well as knowing*****,** conduct, resolving a current split among the US Courts of Appeals.

        - Dodd bill extends this standard to all the Securities Acts ***except for*** the Exchange Act, while the House Investor Protection bill made clear that reckless conduct is covered by all of the Securities Acts.
    - Extends enforcement authority over control persons under the Securities Act and Investment Company Act.
        - Inconsistency between the Dodd bill and the House Investor Protection bill.
            - House Investor Protection bill explicitly provided for control person liability but only under the Exchange Act.
            - The Dodd bill would extend such liability under the Securities Act and Investment Company Act, but not the Exchange Act.
    - Mirrors language in the Specter bill except that it does not extend SEC enforcement authority over reckless conduct under the Exchange 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. Allows for prosecution against whistleblowers who knowingly and willfully provide false information.
    - Very similar to the House Investor Protection bill. Slightly more generous in awards to whistleblowers.
- **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 Investor Protection bill.
- **Restoring State regulatory authority over Regulation D offerings**. Permits state regulation of offerings under Regulation D, including Rule 506 offerings, by repealing the federal preemption provision of the Securities Act with respect to these offerings.

C. Credit Rating Agencies

- Similar in many respects to the House Rating Agencies bill, the Dodd bill generally increases internal controls, requires greater transparency of rating procedures and methodologies, provides the SEC with greater enforcement tools, and provides for SEC examination of nationally recognized statistical rating organizations ("NRSROs")
- **Accountability for ratings procedures**
    - 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.
        - The House Rating Agencies bill would require this as well.

- SEC to issue rules requiring annual internal controls report to SEC.
    - The House Rating Agencies bill does not contain a corresponding provision, although as noted below, the House Rating Agencies bill requires an annual report from the compliance officer.
- The internal controls report required under the Dodd bill must contain:
    - Description of management responsibility in establishing and maintaining internal control structure;
        - The House Rating Agencies bill explicitly tasks the Board of Directors with certain oversight responsibilities, including internal control systems, compensation policies, and establishment, maintenance and enforcement of certain polices and procedures with respect to ratings determinations and conflicts of interest.
    - Assessment of effectiveness of internal control structure; and
    - Attestation of CEO (or equivalent individual).

- **Penalties for certain actions**
    - Broadens available penalties that the SEC may impose to include fines and expands specified misconduct to which such penalties apply to include failure to reasonably supervise an individual who commits a violation of the securities laws.
        - This is also included in the House Rating Agencies bill, which also expands the misconduct to cover a failure to conduct sufficient surveillance of outstanding ratings. The House Rating Agencies bill also applies this section to persons associated with or seeking to become associated with the NRSRO.
    - Allows SEC to suspend or revoke registration of an NRSRO with respect to a particular class or subclass of securities upon a determination, after notice and opportunity to be heard, that NRSRO lacks adequate financial or managerial resources to consistently produce ratings with integrity. SEC must consider:
        - Whether there was a failure over sustained period to produce accurate ratings for that class; whether the performance was significantly worse than other NRSROs; any other factors determined by the SEC.
        - The House Rating Agencies bill does not have a corresponding provision.
- **Management of conflicts of interest**
    - SEC must issue rules to prevent sales and marketing considerations from influencing production of ratings, with SEC able to provide exemptions where such separation is not appropriate.
        - The House Rating Agencies bill requires the SEC to issue rules to prohibit, or require the management and disclosure of, conflicts of interest, including specified conflicts relating to compensation of the NRSRO and certain business relationships and affiliations of the NRSRO or its associated persons.
        - The House Rating Agencies bill includes other specific provisions addressing conflicts of interest that are not reflected in the Dodd bill.

- **Compliance Officer**
    - Designated compliance officer may not perform credit ratings, participate in development of ratings methodologies or methods, perform marketing or sales functions, or participate in establishing compensation levels (except for compliance personnel).
        - SEC may exempt small NRSROs from these limitations on the compliance officer if they would impose an unreasonable burden.
        - The House Rating Agencies bill similarly restricts the compliance officer's participation in certain rating-related activities.
    - New duties of the designated compliance officer:
        - Establish procedures for the receipt, retention, and treatment of complaints about ratings, models, methodologies, or compliance with securities laws, internal policies or internal procedures;
        - Establish procedures for the receipt, retention, and treatment of complaints about employees or users of ratings (confidential and anonymous); and
        - Submission to NRSRO of an annual report on compliance with securities laws and policies and procedures, including description of material changes to code of ethics and conflict of interest policies and a certification of accuracy and completeness.
            - Must also be filed by NRSRO with required financial reports.
            - Both the Dodd bill and the House Rating Agencies bill require an annual compliance report, with a certification, to accompany financial reports submitted to the SEC. The House Rating Agencies bill would require SEC review of the code of ethics and conflict of interest policies annually and whenever these are materially modified.
            - SEC to prescribe matters to be addressed in reports.
    - The House Rating Agencies bill also requires that the compliance officer report directly to the Board of Directors and prohibits the compliance officer's compensation from being tied to business performance. The House Rating Agencies bill also articulates various specific responsibilities of the compliance officer.
- **Financial Statements furnished to SEC**
    - Financial statements are no longer provided "on a confidential basis." SEC may treat as confidential information it determines may have a harmful effect on the NRSRO if published.
        - This is substantially the same as in the House Rating Agencies bill, except that the House Rating Agencies bill requires such reports to be filed with (rather than furnished to) the SEC.
- **Establishment of Office of Credit Ratings within SEC**
    - House Rating Agencies bill also requires SEC to establish an office to administer NRSRO rules.
    - Duties
        - Administer SEC rules. With respect to NRSRO practices in determining ratings; to promote accuracy in ratings; to ensure ratings are not unduly influenced by conflicts of interest.

        - Conduct at least annual examinations of NRSROs, during which it must review:
            - Policies, procedures, and rating methodologies and whether the NRSRO adheres thereto;
            - Management of conflicts of interest;
            - Implementation of ethics policies;
            - Internal supervisory controls;
            - Governance of the NRSRO;
            - Activities of the designated compliance officer;
            - Processing of complaints; and
            - Policies governing post-employment activities of former staff.
                - The House Rating Agencies bill explicitly requires that a 1-year look-back policy be established and be subject to SEC review and calls for reports to the SEC of certain employment situations for persons previously associated with an NRSRO.
        - SEC must make publicly available a report summarizing essential examination findings.
    - Staffing
        - Director (reports to the Chairman of SEC)
            - The House Rating Agencies bill does not specify such a position.
        - Sufficient staffing to carry out Office of Credit Ratings' duties and include persons with expertise in corporate, municipal, and structured debt finance.
            - The House Rating Agencies bill does not specify level of staffing expertise, but also requires sufficient staffing.
    - The House Rating Agencies bill provides for annual examination of policies, procedures and methodologies to review whether an NRSRO has established and documented a system of internal controls, due diligence and implementation of methodologies for determining ratings, adheres to such a system and makes disclosures consistent therewith.
- **SEC establishment of fines and penalties**
    - SEC must establish fines and other penalties applicable for violations of the act/rules and may issue rules as necessary to carry out the Dodd bill.
        - This is also reflected in the House Rating Agencies bill.
- **Disclosure relating to ratings performance**
    - SEC must issue rules to require NRSROs to publicly disclose information on initial ratings published for each type of obligor, security, and money market instrument and any subsequent changes.
        - Purpose is to allow users to evaluate accuracy and compare across NRSROs.
        - Disclosure must: be comparable across NRSROs; be clear and informative for investors with varying levels of sophistication; include performance information over a range of years and for a variety of types of ratings; be published and freely available on the

NRSROs website and in writing upon request; be appropriate to business model.

- The House Rating Agencies bill includes a substantially similar provision.

- **Procedures and methodologies rules**
  - SEC must issue rules with respect to procedures and methodologies, including qualitative and quantitative inputs and models, used by NRSROs.
    - Must require NRSROs to ensure that ratings are determined in accordance with procedures and methodologies that are approved by the NRSRO's board of directors (or body with similar function) and in accordance with policies and procedures for the development of such procedures and methodologies.
    - Must require NRSROs to ensure that when material changes to rating procedures and methodologies are made, they are applied consistently to all ratings to which the changed procedure or methodology applies, they are applied to current ratings to the extent they impact surveillance procedures and methodologies, and the reason for the change is publicly disclosed.
    - Must require NRSROs to notify users of ratings of certain information:
      - the version of a procedure or methodology used with respect to a particular ratings;
      - when a material change is made to a procedure or methodology;
      - when a significant error is identified in a procedure or methodology that may result in rating actions;
      - the likelihood of a change resulting in current ratings being changed.
    - The House Rating Agencies bill requires that an NRSRO's procedures and methodologies and internal control system be reasonably designed to ensure each of these. The House Rating Agencies bill also requires that the procedures and methodologies and internal control system be reasonably designed to use ratings symbols that distinguish structured finance ratings.

- **Disclosure form to accompany ratings**
  - SEC must issue rules to require NRSROs to include a prescribed form with each rating disclosing information about assumptions underlying procedures and methodologies, data relied upon to determine the rating and, if applicable, how servicer or remittance reports were used, and how frequently, to conduct surveillance, as well as information to help users of ratings better understand ratings in each class.
    - Form must be easy to use and helpful for users to understand.
    - Form must contain specified qualitative content, including the ratings produced; main assumptions used in constructing procedures and methodologies; potential limitations of the ratings and the types of risks excluded from the ratings; information on uncertainty of the rating; information on reliability, accuracy, and quality of data relied upon; statement of extent to which essential

data was reliable or limited (*e.g.*, historical scope, accessibility limitations); information on the extent third party due diligence was relied upon, description of information reviewed and summary of findings of third party; description of data about any obligor, issuer, security, or money market instrument relied upon; statement on overall assessment of quality of information available and considered in relation to information available for similar issuances; information on conflicts of interest; additional information required by the SEC.

- Form must contain specified quantitative content: explanation or measure of volatility, including factors that might lead to a change and extent of change to be expected under different market conditions; information on content of the rating, including historical performance or expected probability of default and historical performance or loss to user in event of default; information on sensitivity of rating to assumptions; additional information required by the SEC.
    - Must be directly comparable across types of securities.
- The House Rating Agencies bill includes a substantially similar requirement, but also requires that each such disclosure form include a certification by the NRSRO that the information is true and accurate.

- **Obligations in connection with the use of due diligence services**
    - Any third-party due diligence report in connection with an asset-backed security must be made publicly available by issuer or underwriter.
        - The House Rating Agencies bill does not require this.
    - Any time third-party due diligence services are used by an NRSRO, issuer, or underwriter, the service provider must provide a written certification to any NRSRO that produces a rating to which such services relate.
        - Form and content to be established by NRSRO to ensure service provider conducted thorough review necessary for the NRSRO to provide an accurate rating.
        - SEC rules shall require disclosure of the certification as part of the form accompanying each rating produced.
        - The House Rating Agencies bill contains a substantially similar provision with respect to third-party due diligence certifications.
- **Private right of action against NRSROs for fraud**
    - Modifies the requisite "state of mind" requirements for private securities fraud actions against NRSROs for money damages.
        - Sufficient for pleading a required state of mind that the complaint state with particularity facts giving rise to a strong inference that the NRSRO knowingly or recklessly failed to conduct a reasonable investigation of a rated security with respect to factual elements relied upon by its methodology or to obtain reasonable verification of such factual elements from sources independent of the issuer and underwriter that the NRSRO considered competent.
        - The House Rating Agencies bill makes it sufficient for pleading a required state of mind that the complaint state with particularity

facts giving rise to a strong inference that the NRSRO knowingly or recklessly violated the securities laws. It also notes that statements made by NRSROs shall not be eligible for a forward-looking statement safe-harbor.

- The House Rating Agencies bill also includes a provision that would nullify the effect of Rule 436(g) under the Securities Act.

- **Obligation of NRSRO to report violations of law**
    - NRSRO must refer to law enforcement or regulatory authorities any information received that it finds credible that alleges that an issuer of securities rated by the NRSRO committed or is committing a violation of law.
        - NRSRO need not verify accuracy of reported information.
    - The House Rating Agencies bill does not reflect this requirement.
- **Consideration of outside information to be considered**
    - In producing a rating, an NRSRO must consider information about an issuer that it has or receives from a source other than the issuer, provided that the NRSRO finds it credible and potentially significant to the rating decision.
    - The House Rating Agencies bill does not reflect this requirement.
- **Standards for rating analysts**
    - Within 1 year of enactment, SEC (or designated national securities association) 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.
    - The House Rating Agencies bill does not reflect this requirement.
- **Timing of SEC regulation**
    - All required rulemaking must be completed within 1 year of enactment.
- **Studies and reports**
    - Comptroller General must conduct a study of scope of all laws that require use of NRSRO ratings and evaluate the appropriateness of and necessity for such use; which uses could be removed with minimal market disruption; the potential impact on markets and investors if such uses were rescinded; and whether rescission of such uses would benefit markets and investors.
        - Must take into consideration the views of Federal financial regulatory agencies, hedge funds, banks, brokerage firms, pension funds, and other interested parties.
        - Must report to Senate Banking Committee and House Financial Services Committee on the results no later than 1 year after enactment with recommendations on which such uses could be removed with minimal disruption and whether markets and investors would benefit.
        - The House Rating Agencies bill would require the removal of statutory references to credit ratings and would charge individual agencies with the task of reviewing their regulations and modifying them to remove references to or required reliance upon NRSRO ratings. For agencies not specifically mentioned, the Comptroller

General is given the task of conduct a review and making recommendations to Congress.

- Comptroller General must conduct a study on alternative means for compensating NRSROs to create incentives to provide more accurate ratings and any requisite statutory changes that would be needed to implement this.
    - Must report to the Senate Banking Committee and House Financial Services Committee on the results no later than 1 year after enactment with recommendations for providing incentives to rating agencies to provide more accurate ratings.
    - The House Rating Agencies bill requires the SEC to issue rules regarding the establishment of a system of payment for NRSRO ratings that requires payments be structured in a manner designed to ensure that the NRSRO conducts accurate and reliable surveillance over time and that incentives for reliable ratings are in place.
- Comptroller General must conduct a study on feasibility and merits of creating an independent professional organization for rating analysts employed by NRSROs that would establish independent standards for governing the profession, establish a code of ethical conduct, and oversee the profession.
    - Must report to the Senate Banking Committee and House Financial Services Committee on the results no later than 1 year after enactment.
    - This study is not required by the House Rating Agencies bill
- Comptroller General must conduct a study of the extent to which the SEC's rules have carried out this title.
    - Must report to the Senate Banking Committee and House Financial Services Committee on the results no later than 30 months after enactment.
    - This study is not required by the House Rating Agencies bill.
- Comptroller General must conduct a study of a representative sample of the credit ratings issued by each NRSRO to assess predictive performance of the initial ratings in such sample and the predictive performance of any subsequent rating.
    - Must report to the Senate Banking Committee and House Financial Services Committee on the results no later than 18 months after enactment with the results of the study and a score card evaluating the predictive performance of each NRSRO.
    - The House Rating Agencies bill would require that the SEC modify its NRSRO rules to require that a random sample of ratings histories be disclosed on the NRSRO's website and provided to the SEC in a format consistent with EDGAR publication.
- SEC must conduct a study of the independence of NRSROs and how this impacts ratings issued.
    - Must evaluate conflict of interest management by NRSROs that provide non-rating services, potential impact of rules prohibiting NRSROs from providing other services, any other NRSRO-related issues.

        - Must report to the Senate Banking Committee and House Financial Services Committee on the results no later than 1 year after enactment with recommendations for improving the quality of ratings.
    - The House Rating Agencies bill makes it unlawful, after a 180-day transition, for an NRSRO, an affiliate or a person associated with an NRSRO to provide any non-rating service.

D. Asset-Backed Securitization

- The provisions of the Dodd bill related to asset-backed securities ("ABS") are broadly similar to those in the Treasury proposal.
- ***Scope***: The ABS provisions of the Dodd bill would adopt "skin-in-the-game" requirements for asset originators and securitizers and other provisions to encourage heightened underwriting, risk management and disclosure practices in the asset securitization area.

- ***Definition of Asset-Backed Security***. Unlike the House Interim Version and the Treasury proposal, the Dodd bill defines "asset-backed security" directly, rather than by reference to the definition in SEC Regulation AB (17 CFR § 229.1101(c)).
    - An ABS 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."
        - Examples given include collateralized mortgage obligations, collateralized debt obligations ("CDOs"), collateralized bond obligations, CDOs on ABS, CDOs on CDOs (CDO-squareds) and anything else the SEC determines is an ABS.
    - Explicitly carved out of the definition of ABS is any "security issued by a finance subsidiary held by the parent company or a company controlled by the parent company, if none of the securities issued by the finance subsidiary are held by an entity that is not controlled by the parent company."
        - Removes from the definition of ABS, and therefore the provisions of the Dodd bill, internal financing between parent and subsidiary entities.
    - ***Expanded definition of ABS***. By not using the Regulation AB definition of ABS, the Dodd bill expands the products under its jurisdiction. ABS coverage under the Dodd bill includes the following which are excluded under Regulation AB:
        - Assets that by their terms convert into cash.
        - When neither the depositor nor the issuing entity in an ABS transaction is an investment company under the Investment Company Act or will become one as a result of the transaction.
        - The activities of the issuing entity are limited to passive ownership or holding the pool of underlying assets.
        - When non-performing or delinquent assets are part of the pool.

        - Certain transactions in which the underlying assets are leases.
- ***Definition of Securitizer***. The definition of a securitizer is expanded to include both issuers of ABS and any person "who organizes and initiates an [ABS] transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer." The definition in the Treasury proposal only included issuers and underwriters of ABS.
- ***Credit Risk Retention Requirements***. The Dodd bill reverts to the Treasury proposal formula of requiring securitizers, by default, to retain credit risk in assets transferred, sold or conveyed through issuance of an ABS. It does not follow the House Interim Version in requiring, as a default, the creditor of a loan to maintain credit risk in loans transferred, sold or conveyed to a third party.
    - Unlike the Treasury proposal, and like the House Interim Version, the minimum credit retention level under the Dodd bill would be set jointly by the SEC and the Federal banking agencies (defined as the Federal Reserve, FIRA, and the FDIC) at 10% of the credit risk of the asset conveyed through the ABS. The Federal banking agencies, but not the SEC, are given leeway to change this depending on the due diligence of the party.
    - The Dodd bill would largely keep the other requirements the same as in the Treasury proposal, specifically:
        - The securitizer cannot hedge the required retained credit risk.
        - The SEC and the Federal banking agencies will determine the types of credit retention allowed and the duration required.
        - Securitizations of US, US agency and US government-sponsored enterprise ("GSE") securities would be totally or partially exempted from the credit retention requirement.
        - Other exemptions could be provided "as may be appropriate in the public interest or for the protection of investors."
        - The credit retention requirements can be reallocated between the securitizer and creditor who sold the loan to the securitizer, though, in a new provision, this would need to be done by joint determination of the Federal banking agencies and the SEC.
- ***Due Diligence Analysis***. In a new provision, the Dodd bill requires the SEC to promulgate rules requiring issuers of ABS "to perform a due diligence analysis of the assets underlying the [ABS]" and "to disclose the nature of the analysis."
- ***Enforcement***. The enforcement provisions related to ABS are materially unchanged from the Treasury proposal.
- ***Reporting***. The reporting provisions relevant to ABS, including the removal of the exemption from Exchange Act filing requirements for ABS held by fewer than 300 persons, required disclosure of tranche-, class-, security-, asset- and loan-level data about ABS and required disclosure of risk retention of the securitizer or originator, are materially unchanged from the Treasury proposal.
- ***Representations and Warranties***. The provisions related to representations and warranties from credit rating agencies and originators are materially unchanged from the Treasury proposal.
- ***Removal of Exemptions from Registration***. Like the Treasury proposal, the Dodd bill removes the exemption from Section 4 of the Securities Act for some mortgage-backed securities.

E. Executive Compensation

- **Annual shareholder approval of executive compensation**. Within one year after enactment, companies must provide shareholders with an annual non-binding vote to approve the compensation of executives as disclosed pursuant to SEC rules.
    - Similar to Schumer bill.
- **Shareholder vote on golden parachute policy**. Within one year after enactment, shareholders must approve policies relating to payments to any principal executive officer upon M&A activity.
- **Compensation committee independence**. Listed companies must have compensation committees consisting of independent directors, taking into account the source of director compensation and affiliations with the company.
    - The compensation committee has the authority to engage consultants and advisors. All such advisors must be independent, as defined by the SEC.
    - The compensation committee is directly responsible for the appointment, compensation and oversight of the work of the compensation consultant.
    - The SEC is directed to undertake a 3-5 year study of the use of compensation consultants and the effects of such use on a company's performance.
- **Executive compensation disclosures**. Companies must disclose the relationship between a company's executive compensation and financial performance and provide a graphic or pictorial comparison of the amount of executive compensation and financial performance of the company or return to investors of the company during a 5-year period.
- **Clawback**. Companies must adopt clawback policies for current or former executives, triggered based on material non-compliance of financial reporting requirements that led to accounting restatements, during the 3-year period preceding the date on which the 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.
- **Disclosure regarding employee hedging**. Companies must disclose whether employees are allowed to hedge the value of equity grants.
- **Compensation standards for holding companies of depository institutions**. Amends the Bank Holding Company Act so that it would be considered an unsafe and unsound practice for a holding company 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.
- **Higher capital charges**. Gives the applicable bank regulator the authority to impose higher capital charges if an institution has compensation practices that "pose risk of harm."
- **Compensation standards for holding companies of depository institutions**. Directs the appropriate bank regulator to prohibit unsafe and unsound practices described under the bank holding company standard above.

F. Management of the Securities and Exchange Commission

- **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.
- **Biannual report on personnel management**. Requires the GAO to submit a biannual 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 low- and mid-level 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 5 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 of the SEC of such associations; the oversight by the SEC of the executive compensation of such associations; arbitration services provided by such associations; the review performed by such associations on advertising by its members; and the effectiveness of such associations along with both public and internal confidence in such associations.
- **Compliance examiners**. The Division of Trading and Markets and the Division of Investment Management of the SEC must have a staff of examiners who must perform compliance inspections and examinations of entities under the jurisdiction of those Divisions.
    - Effectively reorganizes the Office of Compliance Inspections and Examination.
- **Reports of misconduct by SEC employees**. 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 misconduct and ineffectiveness.
    - 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.
    - Authorizes the Inspector General to make rewards for suggestions and allegations that may not exceed $50,000, unless the suggestion or allegation has extraordinary merit.

G. Corporate Governance

- **Proxy access**. Within 180 days after enactment, the SEC must issue rules permitting shareholders to use issuer proxy solicitation materials to nominate director candidates.
    - Similar to Schumer bill.
- **Disclosures regarding chairman and CEO structures**. Within 180 days after enactment, the SEC must issue rules to require companies to disclose in the proxy statement why the same or different persons serve as chairman and CEO.
    - Schumer bill would have required all public companies to have independent chairmen.
    - The SEC has already proposed rules requiring companies to disclose its leadership structure and why they believe the structure is best for the company.
- **Majority voting in uncontested director elections**. Within one year after enactment, 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 shall accept the resignation within a period of time as disclosed or decline to accept the resignation and provide the reasons publicly within 30 days.
    - Similar to Schumer bill.
- **Shareholder vote on staggered terms of directors**. Within one year after enactment, listed companies cannot have boards with staggered terms without shareholder approval or ratification.
    - Similar to Schumer bill.
- **Risk Committee**. All firms that are treated as systemically important and are publicly traded must have a risk committee, and all bank holdings companies with assets over $10 billion and are publicly traded would by regulation be required to have a risk committee.
    - Risk committee must have independent directors as specified by the AFS.
    - Risk committee must include one risk management expert having experience in risk management at large complex firms.
    - Prohibition on single risk management standard.
    - Schumer bill requires all public companies to have risk committees.

H. Municipal Securities

- **Municipal Securities Advisors and MSRB Authority**
    - Requires registration and oversight of municipal advisors that provide advice to issuers of municipal securities with respect to the issuance of municipal securities, investment of proceeds of municipal offerings or derivatives on municipal securities. House Investor Protection bill provides for registration and regulation of “municipal financial advisers,” with a carve-out for broker-dealers to the extent acting as underwriters, but vests authority with the SEC.
    - 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.
  - Reconstitutes the MSRB with a majority of board members that are not affiliated with broker-dealers, municipal dealers or municipal advisors. Similar to the House Investor Protection bill.
  - 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.
- **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 mandated issuer disclosure.
  - Requires the MSRB to study the transparency of trading of municipal securities.
  - Requires the SEC to study the funding mechanism for the Government Accounting Standards Board.

I. PCAOB, Aiding and Abetting and Other Matters

- The Dodd bill incorporates certain provisions of the House Investor Protection bill and the Specter bill.
- **Private civil action for aiding and abetting**. Allows for private civil actions against individuals who ***knowingly or recklessly*** aid or abet a violation of the Exchange Act. Overturns the *Stoneridge* decision.
  - Mirrors the relevant language of the Specter bill.
- **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 Investor Protection 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.
- **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 Investor Protection bill.

- **Portfolio margining**: Expands Securities Investor Protection Corporation coverage to include futures and options on futures, and proceeds thereof, that are contained in securities accounts that are a part of a portfolio margining program approved by the SEC.
  - Substantively the same as House Investor Protection bill.
- **Bank/Credit Union Inspector General Reports**. Increases the bank failure threshold at which the inspector general of the appropriate Federal banking or credit union agency is required to provide a written report. Requires the agency inspector general to provide general semi-annual reports for nonmaterial losses.
- **GAO Study on Proprietary Trading**
  - ***Scope of study***. Requires Comptroller General to conduct a study of proprietary trading, including risks (both systemic and to particular institutions), conflicts, disclosure and control systems associated with proprietary trading by and within covered entities and produce a report.
  - ***Considerations of study***. Requires Comptroller General to consider the current practice and the advisability of a complete ban on the activity, limitations on scope of activities, additional capital requirements, enhanced restrictions on intra-affiliate transactions, enhanced public accounting or disclosure requirements, and any other option deemed appropriate.
  - ***Broad access to records***. Provides Comptroller General with access to a broad range of information and data and access to officers, directors, employees, independent public accountants and representatives. Comptroller General is able to make and retain copies of books, records, and accounts.
  - ***Confidentiality limits***. Requires confidentiality of reports Comptroller General, but permits the Comptroller General to disclose information obtained to a department, agency or official of the federal government for official use, a Congressional committee upon request and to a court, upon a court order.
- **Senior investor protection**. Provides grants to states contingent on their limiting use of misleading designations for persons selling securities and insurance, and adopting suitability rules for recommendations of securities and insurance, including annuities.
  - Similar to the House Investor Protection bill.

J. SEC Self-Funding

- **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 request would automatically be given to the SEC.
  - New; the House Investor Protection bill provided the SEC with a set (though increased) budget.

X. The Consumer Financial Protection Agency

- ***Scope:*** The Consumer Financial Protection Agency ("CFPA") established by the Dodd bill is similar in most respects to that established by the House CFPA bill.
- **The CFPA would be given extraordinarily broad and sweeping powers to regulate and enforce substantive standards for financial activities involving "consumer financial products or services."**
  - Unlike the House CFPA bill, the Dodd bill does not exempt small financial institutions from CFPA examination and enforcement, though the Dodd bill prohibits the CFPA from assessing fees on small institutions. However, the Dodd bill does vest the CFPA with the discretion to exempt small institutions.
  - Under the House CFPA bill, examination and enforcement authority with respect to small institutions (insured depository institutions with total assets of $10 billion or less and all insured credit unions with total assets of $1.5 billion or less) would be reserved to the appropriate federal banking agency or the National Credit Union Administration. However, the CFPA would retain, or might be able recapture under certain circumstances, a great deal of examination and enforcement authority even with respect to small institutions.
- The CFPA would have broad authority to seek information, under oath, in virtually any form for any reason from any source.
- The CFPA would have the authority to bring a civil action, after providing notice to the Attorney General, to seek monetary or equitable relief, and could represent itself in its own name in any court, including the Supreme Court.
- The CFPA does not limit state power to regulate consumer financial products and services more strictly than applicable federal standards and state attorneys general would have the ability to bring suits in federal court to enforce federal law.
- The CFPA provides broad authority to the CFPA to assess fees and provides for the Federal Reserve to transfer to the CFPA the "amount estimated by the CFPA needed to carry out" its functions. How this will work with the funding of FIRA is unknown.

Principal Changes

- ***Director and Board:*** The Dodd bill reduces the responsibility of the Director of the CFPA and provides a greater role for the CFPA board of directors.
  - The Dodd bill resembles more closely the Treasury proposals than the House CFPA bill.
- ***Plain Vanilla Products or Services:*** The Dodd bill does not authorize or prohibit CFPA rules that would require a covered person to offer a financial product or service (addressing the so-called "plain vanilla" issue).
  - The Treasury proposals authorized plain vanilla product requirements; the House CFPA bill prohibited them.
- ***Disclosures:*** The Dodd bill authorizes the CFPA to prescribe rules regarding costs, benefits, and risk disclosure to consumers.

- Unlike the House CFPA bill, the Dodd bill does not provide for “model disclosures” and *per se* compliance if those model disclosures are followed.
- ***Funding:*** The Dodd bill does not contain the detail and specifics for funding contained in the House CFPA bill. Instead, it provides broad power to the CFPA to assess fees, with limits on fees that can be assessed on federally chartered insured depository institutions and federal credit unions with assets of less than $10 billion. The CFPA cannot assess fees on state-chartered credit unions and insured depository institutions with assets of less than $10 billion.

Coverage of CFPA

- ***“Deposit Taking Activity”:*** Unlike the House CFPA bill, the Dodd bill grants the CFPA the authority to “determine, by rule, that the term ‘deposit-taking activity’ includes the receipt of money or its equivalent in connection with the sale or issuances of any payment instrument or stored value product or service.”
- ***“Financial Activity”:*** Unlike the House CFPA bill, the Dodd bill specifies that “providing title insurance” is a “financial activity,” subject to the CFPA.
    - The Dodd bill does not provide for two exclusions from “financial activity” that are provided for in the House CFPA bill:
        - publishing newspapers, news magazine, etc.; and
        - providing advice, analyses, or reports on government securities.
    - The Dodd bill removes the restrictions contained in the House CFPA bill that would limit the CFPA’s ability to define “any other activity” as a “financial activity.” The Dodd bill authorizes the CFPA to define “any other activity” by rule as a “financial activity.”
- ***Exclusions from Coverage:*** Unlike the House CFPA bill, the Dodd bill does not exclude from coverage:
    - a person regulated by a state insurance regulator;
    - boards of trade, derivatives clearing organizations, and multilateral clearing organizations;
    - motor vehicle dealers;
    - municipal securities dealers, SROs and the Municipal Securities Rulemaking Board;
    - investment advisers that voluntarily register with the SEC.
- ***ACORN:*** The Dodd bill removes the prohibition on ACORN participating in programs established by the CFPA.
- ***Remittance Transfers*****:** Unlike the House CFPA bill, the Dodd bill does not require disclosure by remittance transfer providers.

Consumer Financial Education

- Like the House CFPA bill, the Dodd bill provides for an “Office of Financial Literacy” designed to “educate and empower consumers to make better informed financial decisions.”
- Unlike the House CFPA bill, however, the Dodd bill does not provide for an “Annual Autopsy.”

XI. Financial Regulatory Agencies Transition Oversight Commission

See Section III, "The Financial Institutions Regulatory Administration — Single Banking Regulator."

XII. Federal Reserve System Provisions

- **Section 13(3) Authority**. Limits Federal Reserve's Section 13(3) emergency lending powers so that assistance is available only in a program or facility with broad-based participation not to any individual, partnership or corporation on an individual basis. Systemically important payment and clearance entities are also included.
    - The Federal Reserve would then be required to provide to the House and Senate within 7 days a report with information regarding that assistance, and every 30 days thereafter. The Federal Reserve can withhold information about the recipient of assistance for 30 days.
    - Similar to the House Interim Version.
- **Reorganization of the Federal Reserve Banks**
    - New provisions in the Dodd bill cut back on the independence of the regional Federal Reserve Banks. Class A directors would be appointed by the Board, not chosen by the stockholding banks; Class B directors would be appointed by the Board, and not elected by the public; two out of three Class C directors would be appointed by the Board, and the third Class C director, to serve as the chairman of the board of the Bank, would be appointed by the President, with advice and consent of Senate.
        - This gives the President and the Senate a say in who runs the Federal Reserve Banks and limits the power of the banking industry.
- **GAO Audits**. The GAO would be authorized to conduct audits of the Federal Reserve's credit facilities, including the facilities set up during the financial crisis.
    - The audit report, the annual financial statements prepared for the Board, and reports relating to the Section 13(3) emergency lending facility, would be publicly available on the Federal Reserve's website.
    - The Federal Reserve has strongly resisted such audits.

Annex A — The Name Game: Confusions Around Terminology

- **Bank Holding Company Act**.

    - "**Financial holding company**," often also referred to as an "**FHC**" – Created by the Gramm-Leach-Bliley Act of 1999, a financial holding company is a bank holding company that meets "well capitalized" and "well managed" standards and has elected the treatment in order to benefit from the wider range of activities that had been prohibited under Glass-Steagall. The broader activities are those that are financial in nature under Bank Holding Company Act Section 4(k), as well as those that are incidental thereto or complementary.

- **House Interim Version in respect of systemic risk regulation**

    - "**Financial company**" – The term "financial company" means any "company or other entity" that is US incorporated or organized, a branch or agency of a foreign bank, a US affiliate or other US operating entity of a foreign company, in each case that is, in whole or in part, directly or indirectly, engaged in "financial activities." "Financial activities" are undefined.

        - Any US incorporated or organized financial holding company or "regular" bank holding company, and any US bank will be covered.

        - The words "in whole or in part, directly or indirectly," would cover a commercial company with a separately incorporated finance arm. However, while both the ultimate parent and its subsidiaries fall under the definition of "financial company", only the financial subsidiaries of a commercial company could ultimately end up a systemically important firm if so designated. See "identified financial holding company" below.

        - The term "financial company" would also encompass insurance companies, investment firms, and brokers, among others. But unlike commercial companies described above, if all they engage in are activities that are financial in nature or incidental thereto under Bank Holding Company Act Section 4(k), those companies would not benefit from the intermediate holding company.

        - A foreign bank that owns a US bank subsidiary and is therefore a bank holding company for purposes of the Bank Holding Company Act would itself not be covered by the term "financial company," but its US bank subsidiary would be. Likewise, the branch or agency through which a foreign bank operates in the US would be a financial company, but the rest of the foreign bank would not be.

    - "**Identified financial holding company**" – A financial company that the Financial Services Oversight Council has designated for heightened prudential standards, i.e. as systemically important. As a result of being designated as a systemically important firm, the entity would be subject to the heightened prudential standards and terms specified in the House Interim Version, but also be treated as a bank holding company that has elected to be a financial holding company for purposes of the Bank Holding Company Act, the FDIA, and all other Federal laws and regulations governing bank holding companies and financial holding companies.

    - The term identified financial holding company does not apply to commercial parents which engage at the time of designation in activities that are not financial in nature or incidental thereto under Bank Holding Company Act Section 4(k). If such an entity is designated as systemically important, it is required to establish an intermediate holding company, and the requirement to establish an intermediate holding company makes that subsidiary the systemically important firm, whereas the parent is not. See "section 6 holding company" below.

- "**Section 6 holding company**" – An intermediate holding company that certain financial companies are required to establish, that must register as a bank holding company, and through which generally all activities that are financial in nature or incidental thereto under Bank Holding Company Act Section 4(k) must be conducted, and all shares of banks or insured depository institutions controlled by the parent must be held.

    - Financial companies required to establish a section 6 holding company are of two kinds:
        - Commercial parents that are designated as systemically important and, at the time of their designation, conduct activities that are financial in nature or incidental thereto under BHCA Section 4(k), and
        - Certain institutions currently operating under one of certain enumerated grandfather provisions under the Bank Holding Company Act, and that on June 30, 2009 controlled shares or conducted activities that are not in compliance with the activities and investment restrictions on financial holding companies in Bank Holding Company Act Section 4.

    - Establishing a section 6 holding company results in the parent company not becoming, or not being treated as or deemed to be, a bank holding company, as it would otherwise become either as a result of the deletion of certain grandfather provisions under the BHCA, or as a result of being designated a systemically important firm. Instead, the parent becomes subject to its own set of rules, including notably a source of strength requirement and restrictions aimed at preserving a separation between financial and commercial activities, such as special 23A and 23B restrictions, anti-tying provisions and cross-marketing restrictions.

- **Dodd bill in respect of systemic risk regulation**
    - "**Financial company**" – The term "financial company" builds up from a series of secondary terms: bank holding company, US nonbank financial company and foreign nonbank financial company.
        - "**Bank holding company**" is defined the same way as in the Bank Holding Company Act.
            - Most major US commercial and investment banks will be covered because they fall within the definition of "bank holding company." This includes each financial holding company under the Bank Holding Company Act.
            - A foreign bank that owns a US bank will also be covered by the term bank holding company.
            - The treatment of a foreign bank that operates in the US through a branch or agency or otherwise doesn't own a US bank is unclear. They are excluded from the definition of a "nonbank foreign financial company" but not clearly picked up by the definition of bank holding company.
    - "**US nonbank financial company**" – A "US nonbank financial company" is a US company that engages, directly or indirectly, in whole or in part, in activities that are "financial in nature" under the Bank Holding Company Act.
        - In terms of activities, "financial in nature" is narrower than the full scope of powers accorded to a financial holding company under the Bank Holding Company Act which can also engage in activities that are "incidental" to financial activities and those that are "complementary" to financial activities.
        - The words "directly or indirectly" and "in whole or in part" would cover the commercial company with a separately incorporated finance arm. Each of the ultimate parent and its subsidiaries, such as an intermediate holding company conducting all financial activities, would be a "US nonbank financial company," so each could become a systemically important firm.
        - Unlike in the House Interim Version, if a commercial company establishes an intermediate holding company, it appears that it would still be included within the definition of financial company.
    - "**Foreign nonbank financial company**" is meant to be the foreign analogue of a US nonbank financial company.
        - It excludes a foreign bank that operates in the US through a branch or agency and is treated as if it were a bank holding company but is not a bank holding company.

    - The use of "directly or indirectly" and "in whole or in part," like in its US analogue, means that the foreign parent company is also captured in the definition. This is in tension with other provisions in the Dodd bill which seem to push applicability decisions to the regulator, e.g. Sections 107(b)(2), 111(k) and 119(b).

  - "**Specified financial company**," and its subcategories – Each "financial company" becomes, if it is made subject to enhanced supervision and prudential standards, either a "specified bank holding company," a "specified foreign nonbank financial company" or a "specified US nonbank financial company," as applicable. Together, they are referred to as "specified financial companies."

    - The Dodd bill also uses the undefined term "specified foreign financial company," which could indicate that in some respects, both specified foreign nonbank financial companies and foreign companies that are bank holding companies were meant to fall under the relevant provisions.

- **House Interim Version and Dodd bill in respect of resolution authority**

  - "**Financial company**" – Any US company that is:

    - a bank holding company,
    - a specified financial company (Dodd bill) / identified financial holding company (House Interim Version),
    - a company predominantly engaged in activities that are financial in nature or incidental thereto under BHCA Section 4(k) (House Interim Version and Dodd bill), or activities that have been identified for heightened standards (House Interim Version), or
    - any of their subsidiaries (but excluding insured depository institutions, certain broker-dealers, and insurance companies).

  - "**Covered financial company**" – A specified financial company (Dodd bill) or identified financial holding company (House Interim Version) in default or danger of default, and the failure and resolution of which under otherwise applicable US laws would have serious adverse effects on US financial stability or economic conditions, and the exercise of the resolution authority would avoid or mitigate such adverse effects. Because the definition of specified financial company in the Dodd bill references a narrower subset of companies than the definition of identified financial company in the House Interim Version, the potential application of the resolution authority is broader in the House Interim Version than in the Dodd bill.

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