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Summary of the Wall Street Reform and Consumer Protection Act Passed by the House of Representatives, December 11, 2009

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What follows is a summary of the Wall Street Reform and Consumer Protection Act passed by the House of Representatives on December 11, 2009. The Act, like Senate Banking Committee Chairman Christopher Dodd's (D-CT) discussion draft, is an omnibus package of all major financial sector legislative reforms under consideration by the 111th Congress. It was passed by a narrow vote of 223 to 202, with all Republicans and 27 Democrats voting no.

The next stage will unfold in the Senate, where Chairman Dodd has reportedly shelved his discussion draft in favor of asking pairs of Democratic and Republican Senators to work together on each of the separate sections of the draft.

Our telescoped summary of the more than one-thousand page Wall Street Reform and Consumer Protection Act is designed to be helpful to those who are following the progress of the financial regulatory reform marathon.

Following the summary are hyperlinks to other resources that provide further detail on this legislative development. These resources include our summary of the Dodd discussion draft, the bill as introduced in the House of Representatives and a chart showing all amendments to the bill since introduction on the House floor. Full copies of the Act are not yet available, and this summary was prepared on the basis of the best available information.

The Wall Street Reform and Consumer Protection Act

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Systemic Regulation

Financial Services Oversight Council

- **Establishment and Role of the Council**
  - The Financial Services Oversight Council (the "Council"), an interagency council, is established.
  - The Council:
    - Oversees systemic risk, advises Congress, develops strategies to prepare for potential threats to the stability of the US financial system, and identifies systemically important companies and activities in consultation with the Federal Reserve and primary financial regulatory agencies.
    - Studies effects of regulations and standards of the Consumer Financial Protection Agency ("CFPA") on all covered persons.
    - Provides comments to SEC and any standards setting body with respect to accounting principle, standard, or procedure.
    - May resolve jurisdictional disputes among Federal financial regulatory agencies upon request by an agency involved in the dispute.
- **Members of the Council**
  - Treasury Secretary would serve as chairman.
  - **Voting Members.** Federal Reserve Chairman; Comptroller of the Currency; Director of OTS (to be eliminated); SEC Chairman; CFTC Chairman; FDIC Chairperson; FHFA Director; NCUA Chairman; CFPA Chairman.
  - **Nonvoting Advisory Members.** Federal Insurance Office ("FIO") Director; a state insurance commissioner; a state banking supervisor; a state securities commissioner.
- **Council is Not an Agency.** Therefore, it is not subject to the Administrative Procedure Act, Freedom of Information Act and Sunshine Act, among others. GAO can audit any activity and financial transaction of the Council, and of any person under its authority/acting on its behalf to the extent of such work for the Council.
- **Role of Federal Reserve as "Agent" of the Council**. The Federal Reserve is the agent of the Council with respect to systemic regulation.
- **Other Regulators**
  - "Primary financial regulatory agencies" have consultation rights and power to enforce prudential standards with respect to systemically important companies.
    - Federal Reserve's domain includes, among others, bank holding companies and subsidiaries, systemically important companies and subsidiaries, former OTS

functions over savings and loan holding companies, as well as foreign banks treated as bank holding companies under the International Banking Act.

- SEC's domain includes, among others, broker-dealers, registered national securities exchanges, securities-based swap execution facilities, and credit rating agencies.

- FDIC's domain includes, among others, any insured State branch of a foreign bank.

- The only state authority treated as a primary financial regulatory agency is, with respect to insurers, state insurance authorities.

- Authority granted to agencies is in addition to, and does not limit, any existing authority.

Prudential Regulation Generally

- **Systemically Important Firms**. Sets out general principles for identification, enhanced supervision and regulation, and stricter prudential standards. These principles will be fleshed out by US banking regulators in light of Basel, G-20 and FSB standards if the Act becomes law.

  - Standards include:

    - Risk-based capital, which regulators must seek to make countercyclical

    - Leverage limits currently set at 15 to 1 by statute

    - Liquidity

    - Risk management

    - Federal Reserve may impose short-term debt limits, including on off-balance sheet items

  - **Credit Concentration Limits**. Single counterparty limit at 25% of capital stock and surplus or lower amount set by Federal Reserve regulation to mitigate risks to financial stability. Credit exposure broadly defined to include derivatives, repos, securities loans, and anything Federal Reserve determines to be similar. Limits subject to a transition period of 3 years from Act's passage, extendible by Federal Reserve for 2 more years to promote stability. Credit exposures of the firm and credit exposures of others to the firm must also be reported to the Federal Reserve.

  - **Differentiated Treatment**. Systemically important firms may be treated differently from one another, individually or by category.

  - **Prompt Corrective Action Regime Generally**. Federal Reserve has prompt corrective action authority. Capital levels of "well capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized," to be defined by Federal Reserve, which must define "significantly undercapitalized" at a threshold it determines to be prudent for the effective monitoring, management and oversight of the financial system. With worsening capital levels, a growing menu of responses becomes available.

- **Asset Sale and Break-up Powers**. If a systemically important firm poses a "grave threat," the Council must take action. Available actions include modifying prudential standards, terminating activities or imposing new conditions, limitations on mergers or products, and if Council deems other measures inadequate, asset sale/break-up. Judicial review possible.

- **Proprietary Trading**. Can be prohibited by Federal Reserve as necessary to mitigate "existing or foreseeable" threat to systemically important firm or US financial stability.

- **M&A Activity**. Can be prohibited by Federal Reserve if concentration of liabilities likely to "pose great threat to financial stability" in times of severe economic distress.

- **Contingent Capital Requirements**. May be required by Federal Reserve regulation, in coordination with appropriate regulator. Exchange to equity triggered when systemically important firm fails to meet prudential standards <u>or</u> threat to US financial stability demands it.

- **Quarterly Stress Tests**. Federal Reserve, in coordination with primary financial regulatory agency, must conduct annual stress tests of each systemically important firm, and publish a summary of the results. Each systemically important firm must conduct quarterly stress tests, and report results to Federal Reserve and primary financial regulatory agency. Semiannual stress tests are to be conducted by any other financial company with more than $10 billion in total assets.

- **Living Wills**. Required by systemically important companies (except foreign companies, we believe) and must be periodically updated and reported to the Federal Reserve and approved by the Federal Reserve and the FDIC.

- **Activities and Practices**. Stricter standards can be imposed on any activity or practice across regulated financial firms, **whether or not systemically important**.

  - Council is authorized to subject financial activities and practices to stricter prudential standards. Must determine that the conduct, scope, nature, size, scale, concentration, or interconnectedness of such activity or practice could create or increase the risk of significant liquidity, credit, or other problems spreading among financial institutions or markets and local, minority, or underserved communities, and thereby threaten the stability of the financial system or economy.

  - Federal Reserve, as agent of Council, recommends prudential standards to the appropriate primary financial regulatory agencies. **The actions recommended may include prescribing, limiting or prohibiting the activity or practice altogether.**

"As if" Bank Holding Companies

- **"As if" Bank Holding Companies.** A financial company that, before its identification as systemically important, is not a bank holding company, will be treated "as if" it were a bank holding company that is a financial holding company as far as certain banking laws described below are concerned. Foreign banks with branches and agencies in the US do not fall under this category as they are already "treated as" bank holding companies. This category could cover insurance companies whether or not they own a thrift and any other type of financial company newly identified as systemically important that is not already a bank holding company or treated as if it were one.

- **Greater Flexibility in Imposing Stricter Standards**. For "as if" bank holding companies, the Federal Reserve is instructed to take into account whether the financial company owns or controls an insured depository institution and must adapt the prudential standards as appropriate in light of any predominant line of business of such company, including assets under management or other activities for which the heightened capital requirements are not appropriate.
  - The Federal Reserve may exempt such a company from risk-based capital requirements and leverage limits if deemed inappropriate because of such company's activities or structure, but must apply other standards that result in appropriately stringent controls.
- **Certain Banking Laws Applicable**. Certain Bank Holding Company Act and Federal Deposit Insurance Act provisions will apply to "as if" bank holding companies regarding administration, restrictions on non-banking activities, enforcement and sanctions, as if the firm were a bank holding company with elective financial holding company status, bank holding company subsidiaries and the Federal Reserve as regulator.
  - The Federal Reserve is required to adapt non-banking activities limitations flexibly, taking into account business practices, to avoid unnecessary burden and expense.
  - The "as if" bank holding company is not required to register as a bank holding company.
- **Intermediate Holding Companies**. Systemically important companies that are engaged in commercial activities may be required to establish intermediate holding companies, subject to exceptions for companies predominantly engaged in financial activities. Therefore, as a practical matter, the "as if" bank holding company could be an intermediate holding company or the parent, depending on Federal Reserve and company decisions later on. See "Changes in Bank Holding Company Regulation—Intermediate Holding Companies," below.

Foreign Financial Institutions

- **Reach to Foreign Parent.** If a foreign financial company has significant operations in the US through a Federal or State branch or agency of a foreign bank or a US affiliate or other US operating entity, it is a "foreign financial parent," and it and/or its US operations can be made subject to the systemic risk provisions of the Act.
- **Identification as Systemically Important and Application of Prudential Standards**
  - **Identification.** In identifying a foreign company as systemically important, the Council must consider the extent to which it is subject to prudential standards on a consolidated basis in its home country, administered and enforced by a comparable supervisory authority.
  - **Prudential Standards.** In subjecting a systemically important foreign company to stricter standards, the Federal Reserve must take into account the extent to which the parent is subject to comparable home country standards on a consolidated basis, to give due regard to the principle of "national treatment," which requires treatment on par with US institutions, and to ensure that foreign institutions and US institutions have equality of competitive opportunity.

- **Termination Authority**

  - **Termination of Conditions, Activities or Practices**. Upon a finding by the Federal Reserve that a condition, practice, or activity of a systemically important foreign company poses a threat to financial stability or does not comply with the Act or with the Federal Reserve's rules or orders, the Federal Reserve may take actions necessary to mitigate such risk, including ordering termination of the activities of the US branch, agency or subsidiary. Notice and opportunity for a hearing available, other than in urgent cases.

  - **Termination/Establishment of a Foreign Bank Office in the US.** The Federal Reserve may terminate the activities of the US branch, agency or commercial lending company of a foreign institution that presents a systemic risk to the US if the Federal Reserve determines that the home country has not adopted, or made demonstrable progress toward adopting, an appropriate system of financial regulation to mitigate such systemic risk. The Federal Reserve may also take these criteria into account when deciding to approve a new branch, agency or commercial lending application. The SEC may terminate US broker-dealer registrations under the same circumstances. The Act does not define the circumstances under which a firm is deemed to present a systemic risk to the US.

- **Requirements Not Applicable to Foreign Entities**

  - **No prompt corrective action**. Foreign financial parents are not subject to the Federal Reserve's prompt corrective action regime.

  - **No living will or credit exposure reports.** We believe that the Act is intended to exempt foreign institutions from living will requirements, although there is ambiguity in the current language. Foreign financial parents are not subject to the reporting requirements for living wills or credit exposures.

- **Prudential Requirements Not Applicable to Activities Abroad**

  - **Activities Restrictions.** The activities restrictions of the Bank Holding Company Act do not apply to any activities that a foreign systemically important company conducts **solely outside the US** if such activities are conducted **solely by a company or other entity that is located outside the US**.

  - Where stricter prudential standards are adopted with respect to financial **activities and practices** because of their systemic risk, they do not apply to activities that a foreign financial parent conducts solely outside the US if such activities are conducted solely by a company or other operating entity that is located outside the US.

- **Reports.** Before requiring the submission of reports from foreign financial parents, the Council or Federal Reserve must to the extent appropriate coordinate with foreign regulators and multilateral organizations and, whenever possible, rely on information already being collected by such foreign regulators or multilateral organizational with English translation.

- **International Policy Coordination**

  - The President or his designee must coordinate to establish through all available international policy channels similar policies as found in US law related to limiting the

scope, nature, size, scale, concentration, and interconnectedness of financial companies in order to protect financial stability and the global economy.

- The Federal Reserve and the Treasury Secretary must consult with their foreign counterparts and through appropriate multilateral organizations to reach agreement to extend comprehensive and robust prudential supervision and regulation to all highly leveraged and substantially interconnected financial companies.

Changes in Bank Holding Company Regulation

Expansion of Bank Holding Company Regulation

- The Act generally expands the range of companies treated as bank holding companies to include most thrift holding companies, as well as companies that acquire industrial banks or industrial loan companies in the future.

- It does so by eliminating the exemptions from the term "bank" for:

  - Insured thrifts, other than thrifts that are controlled by a company that is, together with its affiliates, predominantly engaged in the insurance business or is a fraternal beneficiary society.

  - Industrial banks and industrial loan companies, other than such an entity that predominantly provides financial products and services to current and former members of the military and their families and is controlled by a savings and loan holding company.

- The Act clarifies that the exemption from the term "bank" for credit card banks extends to credit card issuers and issuers of other credit devices (including virtual or intangible devices) that function as credit cards and that the exemption is not lost if the credit card bank also makes small business commercial loans.

- The Act clarifies that savings and loan holding companies that become bank holding companies under the Act may continue to engage in certain listed activities that they have continuously conducted since June 30, 2009.

Intermediate Holding Companies

- **Purpose**

  - The intermediate holding company regime is a creation of the Act, designed to facilitate targeted Bank Holding Company Act regulation of certain companies that own insured thrifts, industrial banks or industrial loan companies and systemically important financial companies that do not control a US bank by requiring them to segregate their financial and nonfinancial activities.

- **Scope**

  - As a general principle, in the case of a **non-systemically important company with a "bank" subsidiary**, both the intermediate holding company and the parent would be treated as bank holding companies.

- In the case of a **grandfathered unitary thrift holding company** under the Gramm-Leach-Bliley Act of 1999 or a **company that controlled** or had an application pending to acquire control of **an industrial bank or industrial loan company** before November 23, 2009, the intermediate holding company, but not the parent, would be treated as a bank holding company.

    - Such a parent will lose its grandfathered status and be treated as a bank holding company if, among other things, its thrift, industrial bank or industrial loan company subsidiaries fail to comply with any of the conditions for exemption in effect prior to the date of enactment of the the Act or if it acquires control of another bank or insured depository institution after June 30, 2009.

- Non-systemically important companies that are predominantly engaged in the **insurance business** on a consolidated basis are neither treated as bank holding companies nor required to set up intermediate holding companies.

- As a general principle, in the case of a **systemically important financial company that does not control a US bank**, the intermediate holding company, but not the parent, would be treated as a bank holding company for the purposes of administration, non-banking activities, enforcement and sanctions.

    - The Federal Reserve has the discretion to exempt **such companies** from the intermediary holding company requirement if they are **predominantly engaged in financial activities** or activities that are incidental to a financial activity.

    - If the Federal Reserve grants such an exemption from the intermediary holding company requirement, the **parent** would be treated **as if** it were a **bank holding company,** but the Federal Reserve would be required to "flexibly adapt" the otherwise applicable activities restrictions and ownership limitations "taking into account the usual and customary practices in the business sector of" the parent "so as to avoid unnecessary burden and expense." See "Systemic Regulation—"As if" Bank Holding Companies" above.

    - The Federal Reserve may also grant exemptions from any of the intermediate holding company requirements.

- **Description of Intermediate Holding Company Regime**

    - Financial activities must generally be conducted within the intermediate holding company, and the intermediate holding company is generally subject to activities restrictions under the Bank Holding Company Act.

        - Internal financial activities, certain financial activities with both affiliates and non-affiliates, and transactions involving credit for certain purchase/lease transactions need not be conducted within the intermediate holding company.

        - **Permanent grandfather** for any impermissible non-banking activities of an existing intermediate holding company engaged in for 6 months before the passage of the Act and related securities and other assets and the retention of anything owned at time the Act was passed.

- **Source of Strength.** Parent must serve as a source of strength to the intermediate holding company.

- **Firewalls**

  - Section 23A/23B

    - The Section 23A and 23B restrictions on affiliate transactions apply to any transaction between the intermediate holding company and its subsidiaries, on the one hand, and any affiliate (including the parent) not in the intermediate holding company chain, on the other hand, as if the intermediate holding company and its subsidiaries were all member banks. This amplifies the normal Section 23A and 23B restrictions beyond circumstances where a "bank" is a counterparty.

    - Further, a depository institution controlled by such an intermediate holding company is prohibited from engaging in any transaction covered by Section 23A with any non-subsidiary affiliate of the intermediate holding company.

    - **For both**, statutory exception applies for transactions in connection with bona fide third party purchase/lease of assets, goods or services, unless the Federal Reserve regulates otherwise.

  - 25% board independence requirement and limitations on officer interlocks.

  - Anti-tying provisions made applicable to parent and non-bank affiliates as if the parent or affiliate were a bank. Cross-marketing restrictions were in an earlier draft of the Act but were dropped.

  - Operational and legal separation pursuant to Federal Reserve regulations, except for internal functions.

Enhanced Regulation of Bank Holding Companies

- **Federal Reserve Authority to Regulate Functionally Regulated Subsidiaries of Bank Holding Companies.** Allows Federal Reserve expanded authority to examine, prescribe regulations or otherwise take any action pursuant to any provision of the Bank Holding Company Act or section 8 of the Federal Deposit Insurance Act with respect to a functionally regulated subsidiary of a bank holding company. Reverses the Gramm-Leach-Bliley "Fed lite" provisions.

  - **Functionally Regulated Subsidiary.** Defined as any bank holding company subsidiary, except a depository institution, that is a broker dealer, investment company, investment advisor, or a futures commission merchant, commodity trading advisor or commodity pool operator. Does not appear to include insurance companies in the definition.

- **Well Capitalized and Well Managed at the Financial Holding Company Level.** A financial holding company must be well capitalized and well managed at the holding company level, not just at the depository institution subsidiary level, to qualify for financial holding company status.

- **Examination Fees.** Requires Federal Reserve to assess fees on bank holding companies with total consolidated assets of $10 billion or more to defray the cost of examination of such bank holding companies.

Enhanced Regulation of Depository Institutions Generally

- **Capital and Management Requirements for Interstate Acquisitions**. Requires the acquiring bank to be well capitalized and well managed to make an interstate bank acquisition, not merely adequately capitalized and adequately managed.

- **Enhanced Affiliate Lending Limits**

  - **Application of Federal Reserve Act Section 23A to Derivatives.** Subjects derivative transactions and securities borrowing and lending transactions with affiliates to Section 23A limitations. Requires collateral for credit transactions to be maintained at all times. Treats financial subsidiaries as affiliates for purposes of Section 23A. Limits the Federal Reserve's authority to grant exemptions under Sections 23A and 23B.

  - **Inclusion of Derivatives in Lending Limits.** Treats credit exposure from derivatives as a "loan or extension of credit" when applying lending limits applicable to national banks and savings associations. Permits the regulator to include liabilities to advance funds to or on behalf of a person in this calculation.

  - **Transactions with Insiders.** Strengthens lending limits and limitations on asset purchases with insiders.

- **Limitations on Acquisitions and Activities**

  - **Bank and Nonbank Acquisitions**. Requires the Federal Reserve to take into consideration the financial stability of the United States when approving a bank or nonbank acquisition.

  - **Nonbank Acquisitions over $25 billion.** Requires Federal Reserve prior approval of a financial holding company's acquisition of any nonbank company 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 regulator must take into account the risks to the stability of the US financial system and economy created by the transaction, in addition to the other factors to be considered already under the statute.

  - **Expansion of Nationwide Deposit Caps to all Insured Depository Institutions.** Expands nationwide deposit cap limitation on interstate merger transactions to apply to transactions involving all insured depository institutions (including thrifts), and not just banks.

- **Restrictions on Conversions of Troubled Banks**. Prohibits conversion of national banks and thrifts into state banks or thrifts, and vice versa, during any period in which the entity is subject to formal and informal enforcement actions, including memoranda of understanding.

- **Expands interstate branching**
  - Allows interstate branching for national banks and state insured banks provided the law of the State where the branch is to be located would permit the establishment of the branch if such bank were a state bank chartered by such State, and Community Reinvestment Act, capital and management conditions of existing federal law are met.
  - Replaces the current regime of "opt-in" election and thereby aligns the status of national banks and insured state banks with that of federal savings associations that meet applicable OTS rules.
    - Under current law, states are authorized to determine whether to allow out-of-state banks to establish de novo branches.
  - **Interplay with consumer protection laws.** The attractiveness of expanded interstate branching will be influenced by the ability of federal banking regulators to act under the preemption provisions with respect to state consumer protection laws, as described below under "Consumer Financial Protection Agency."
- **Interest Bearing Transaction Accounts.** Eliminates the federal prohibitions on paying interest on demand deposits, thus allowing businesses to have interest bearing checking accounts.

Mutual National Banks and Federal Mutual Bank Holding Companies

- **Creation of a Mutual National Bank Charter**.
  - Provides for "mutual national banks," which are national bank associations operated as mutual depositories. Chartered and regulated by the Office of the Comptroller of the Currency ("OCC"). For up to 3 years from enactment of the Act, certain existing regulations of the OTS also apply.
  - Any mutual depository may convert to a mutual national bank with at least 30 days' notice, and mutual national banks may reorganize as stock national banks or convert to a state bank charter. Demutualization must be done by liquidation or conversion to a stock national banking association.
  - Members are all tax-liable depositors of mutual national banks as well as of depository subsidiaries of a federal mutual bank holding company. Members have rights agreed upon, as well as the right to elect directors, attend board meetings, subscription rights, residual assets on liquidation, and proxy rights.
- **Federal Mutual Bank Holding Companies** are mutual holding companies that own a majority of shares or one or more depository subsidiaries, subject to certain conditions. Federal Reserve is given new supervisory or regulatory authority in respect of federal mutual bank holding company.
  - Mutual national banks may reorganize to become federal mutual bank holding companies subject to approval under the Bank Holding Company Act, submission of a reorganization plan to the bank holding company regulator for approval and issuance of appropriate charters. Approval of plan by a majority of directors and members required.
  - Regulated under the Bank Holding Company Act like any other company that controls a bank. Subject to regulations by the chartering authority.

- Members have same rights as in a mutual national bank. Members include the deposit account holders of each depository subsidiary.

- Bank holding company regulator may petition for bankruptcy in case of default or foreclosure, with residual proceeds to members. If FDIC incurs a loss, FDIC succeeds to depositors' rights as members of the holding company.

- Mutual holding companies, including State mutual depository holding companies, may convert to federal mutual bank holding companies with at least 30 days' notice.

OTS Abolished

- **Abolishes OTS and Transfers OTS Powers to Other Agencies**

  - Transfers all OTS powers to OCC except with respect to savings and loan holding companies, which powers are transferred to the Federal Reserve, and state thrifts, which powers are transferred to the FDIC. Establishes a Division of Thrift Supervision within the OCC. Thrift charter would continue to exist.

  - Federal Reserve Chairman assumes OTS's position on the FDIC's board of directors.

  - Federal thrifts and savings and loan holding companies would be subject to management interlocks provisions.

- **Transfer Mechanics.** Transfer of functions 1 year after the Act becomes law, extended under certain circumstances by 6 months. Provides for savings provisions and coordination of transition activities.

Resolution Authority

- **FDIC as Receiver for Financial Companies.** Creates a new resolution authority which can be invoked with respect to a bank holding company, a systemically important financial company, an insurance company, or any other financial company, instead of bankruptcy.

- **Scope of Application.** In the event the Federal Reserve, the appropriate regulatory agency, and the Treasury Secretary (in consultation with the President) makes certain systemic risk and financial distress determinations, the FDIC would be appointed the receiver of the covered financial company.

  - The resolution authority would not apply to insured depository institutions or insurance companies, which would be resolved under their existing insolvency regimes. Broker-dealer subsidiaries would also be exempt from the resolution authority, unless the broker-dealer itself is designated a financial company subject to stricter prudential standards.

  - The receivership would be limited to one year, subject to up to two one-year extensions.

  - The FDIC can convert the receivership to an involuntary bankruptcy at any time, become the trustee in bankruptcy, and continue to operate a bridge financial company.

- **Authorized Actions.** The FDIC's authority as receiver is modeled on bank resolution rules rather than Bankruptcy Code principles.

- As receiver, the FDIC can take certain emergency stabilization actions, including making loans to, or purchasing debt, purchasing assets, assuming or guaranteeing obligations, taking liens on assets, and selling or transferring assets or liabilities of, the covered financial company.

- The FDIC can also establish a bridge financial company to which to sell or transfer assets and liabilities.

- Among the requirements under the resolution authority, taxpayer funds must be repaid before any payments are made to creditors, unsecured creditors must bear losses, and the management and board members responsible for the failed condition must be removed.

- The FDIC also has the authority to determine claims and to discriminate within the same class of creditors.

- **Bankruptcy Code Principles.** The resolution authority applies very different rules governing creditors' rights borrowed from bank resolution provisions rather than well-known rules from the Bankruptcy Code, including rules regarding treatment of contingent claims, avoidance of security interests, repudiation of contracts, and damages determinations.

- **Judicial Review.** There is no judicial review of the FDIC's actions during the resolution and administrative claims process, only limited after-the-fact *de novo* review.

- **Rulemaking.** The FDIC is permitted to, but not required to, make rules and regulations to implement this authority, with certain exceptions:

  - The FDIC is required to prescribe rules regarding the allowance and disallowance of claims; and

  - The FDIC is required to prescribe rules regarding the priority of expenses and unsecured claims.

- **Haircut on Secured Creditors.** In the event there is a shortfall in the amount owed to the US or to the Systemic Dissolution Fund, the FDIC is permitted to treat up to 10% of a secured claim, including a repo claim (other than a security interest of the federal government) as an unsecured claim, if:

  - The security interest secures a qualified financial contract with an original term of 30 days or less,

  - The collateral is other than certain government-issued securities, and

  - No funds are available for payment, in whole or in part, to any unsecured creditors or shareholders. Language suggests that funds for payment must come from the company, rather than the Dissolution Fund.

- **Qualified Financial Contracts.** The Act provides for a one-day stay on close-out or netting of qualified financial contracts ("QFCs"), during which time the FDIC can determine whether to repudiate or transfer the QFCs. However, if the FDIC repudiates or transfers any single QFC with a particular counterparty, it must repudiate or transfer all QFCs with that counterparty.

- **Guaranteed Minimum Recovery.** A provision of the resolution authority requires that if any unsecured creditor is favored over other unsecured creditors, then the disfavored unsecured creditors must receive at least as much as they would have received in a liquidation under the Bankruptcy Code.
    - The FDIC would be required to make a report every 6 months while acting as receiver on, among other things, the extent to which creditors will receive this minimum recovery amount.
- **Dissolution Fund.** The Act would establish a Systemic Dissolution Fund, pre-funded by FDIC assessments on large financial companies, to pay for the authorized actions under the authority.
    - Risk-based assessments would be levied on financial companies having assets of $50 billion or more. The Senate proposal sets the threshold at $10 billion or more.
        - Financial companies that manage hedge funds with $10 billion or less of assets under management would not be assessed.
    - The maximum size of the Fund is set at $150 billion; however in certain circumstances the FDIC can borrow additional funds from the Treasury to bring the Fund up to $200 billion.
    - Authorizes the Treasury to conduct a study to determine how the resolution authority should be funded.
- **Shortfall in TARP.** In addition to assessments to capitalize the Fund, the FDIC would be authorized to make risk-based assessments on financial companies (no dollar threshold provided for), to pay for any shortfall in TARP.

Derivatives

Mandatory Clearing

- Imposes a central clearing requirement on swaps and security-based swaps ("SBS") that clearinghouses will accept for clearing and that the CFTC/SEC requires to be cleared.
- **End Users**. Exception from central clearing requirement for end users who enter into swaps or SBS to hedge commercial risk and whose swaps do not pose a systemic risk.
- **Transparency.** Requires that all non-cleared swaps be reported to a swap repository or the SEC/CFTC. The SEC and CFTC must make public aggregate data on all cleared and non-cleared swaps.

Trade Execution Requirements

- Requires that all swaps/SBS that are subject to a clearing requirement be exchange-traded or traded on a swap execution facility. All swaps/SBS with certain small municipalities and "unsophisticated" investors (non-eligible counterparties) must be exchange-traded.
- Defines swap execution facility as any person or entity that facilitates or executes swap/SBS trades, including any electronic trade execution or voice brokerage facility. Swap execution facilities must register with the CFTC/SEC and comply with recordkeeping and reporting rules and prevent conflicts of interest, among other requirements.

    - Swap execution facility is defined extremely broadly and could pick up virtually any swap/SBS dealer. Definition will need to be narrowed by CFTC/SEC.

- Swap execution facilities must make public timely information on trading data.

Regulation of Dealers and Major Swap/SBS Participants

- Major swap/SBS participant is defined as any person who is not a swap dealer and:

    - who maintains a substantial net position in outstanding swaps/SBS, excluding positions held primarily for hedging, reducing or otherwise mitigating its commercial risk; or

    - whose outstanding swaps/SBS create substantial net counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets. CFTC/SEC to define the operative terms.

- A person may be designated as a swap/SBS dealer or major swap/SBS participant for a single type or class of swaps/SBS and not considered such for other types or classes.

- **Registration.** Swap/SBS dealers and major swap/SBS participants must register with the CFTC/SEC and comply with reporting, recordkeeping, business conduct and other requirements set by the CFTC/SEC.

- **Prudential Regulation**. Requires dealers and major swap/SBS participants to comply with capital and initial and variation margin requirements set jointly by prudential regulators or the CFTC/SEC, with capital requirements likely to be higher for non-cleared swaps/SBS. Prudential requirements must:

    - help ensure the safety and soundness of the dealer or swap/SBS participant; and

    - be appropriate for the risk associated with the non-cleared swaps held as a dealer or major swap/SBS participant.

- **Segregation of Collateral**. At the request of a counterparty, a dealer must segregate and hold in an account carried by an independent third-party custodian the assets held as collateral for non-cleared swaps/SBS. The Act does not impose segregation requirements for cleared swaps. Clearing houses may continue to segregate margin as is current practice.

    - Limits segregation requirements to initial margin or collateral.

    - The independent custodian cannot be substantially owned or controlled by the swap/SBS dealer or major swap/SBS participant counterparty.

- **Position Limits**. Requires the CFTC, and allows the SEC, to set position limits for certain swaps/SBS. Requires the CFTC to set limits, subject to bona fide hedging exemptions, for certain contracts for physical commodities. The SEC does not have authority to set independent position limits for listed securities underlying SBS.

- **Restrictions on the Governance of Clearinghouses, Boards of Trade, Exchanges and Swap Execution Facilities**

- Rules of clearinghouses, boards of trade, exchanges and swap execution facilities must:
    - Prohibit identified financial holding companies that are swap/SBS dealers, major swap/SBS participants (and associated persons) in aggregate from being able to vote more than 20% of the votes entitled to be cast on any matter.
        - Divestiture of interests acquired in operational entities before January 1, 2010 is not required. SEC and CFTC may determine whether acquisitions in the interim were for the purpose of evading regulation.
    - Prohibit a majority of the directors from being associated with an "identified financial holding company" that is a swap/SBS dealer, major swap/SBS participant or associated person
- CFTC/SEC may prescribe rules that limit the extent to which a dealer or major swap/SBS participant may conduct business with a clearinghouse, board of trade/exchange or swap execution facility that clears or trades swaps/SBS and in which such a person has a material debt or equity investment.

Scope of Regulatory Authority

- **Foreign Exchange Forwards and Swaps**. CFTC and the Treasury Secretary have authority to decide to regulate foreign exchange swaps and foreign exchange forwards as swaps.
- **Commodity Forwards as Swaps**. Commodity forwards are swaps unless the counterparties intend to physically settle the transaction.
- **Extraterritoriality**. Limits its extraterritorial reach by excluding from regulation activities outside the United States unless they have a direct and significant connection with activities in or effect on US commerce or contravene rules and regulations that the CFTC / SEC prescribes to prevent evasion of regulation.
- **Insurance Law**. Preempts state insurance law for swaps/SBS.

Consumer Financial Protection Agency

- **Composition**. Headed by a Director with plenary authority for two years, and thereafter by a five-person Commission, in each instance appointed by the President by and with the advice and consent of the Senate.
    - Commission members appointed to staggered five-year terms.
- **Authority**. The CFPA's authority extends to any person engaged in a "financial activity" in connection with a consumer financial product or service. CFPA will assume broad authority from existing banking and other regulators over — unless explicitly carved out — all financial institutions with respect to all consumer financial products, services and activities.
    - Covered "financial activities" include deposit-taking, money acceptance and money movement; extension and servicing of most types of credit (*e.g.*, mortgage loans, personal loans, credit cards); acting as a financial or investment adviser not regulated by the SEC, CFTC or similar body; money transmittal and engaging in the money services business; sale or issuance of stored value (gift cards/service vouchers);

custodial activities; check cashing and pay day lending; in certain instances, consumer reporting/credit bureau activity; debt collection; real estate settlement, including title insurance; acting as a leasing agent, broker or adviser in connection with rent-to-own activities; providing certain financial data processing and data transmission services; tax planning; person-to-person lending; any other activity that the Director defines, by regulation, as a financial activity after finding that the activity is financial in nature or is otherwise a permissible activity for a bank or bank holding company, including a financial holding company; and any activity incidental or complementary to any other financial activity regulated by the CFPA.

- **Broad Carve-outs for Broker-Dealers, Investment Advisers and Other Regulated Entities, but Ambiguities Remain**. Carves out from the authority of the CFPA any person "regulated by" the SEC, the CFTC or a state securities commission, which would include broker-dealers and most investment and financial advisers, but only to the extent that such persons "act in a registered capacity."
  - Unclear whether this carve-out applies to any ***supervised*** activity, or only to activities ***for which registration is required.***
    - Without clarification, likely to lead to jurisdictional battles concerning offer and sale of products that are not securities and that may be broadly viewed as consumer financial products (*e.g.*, private label credit cards).
  - Others excluded from the authority of the CFPA include insurance companies; sellers of nonfinancial goods or services who extend purchase money credit; auto dealers; accountants, tax preparers and attorneys; real estate licensees; employee benefit plans.
- **Smaller Financial Institutions will Continue to be Subject to the Examination and Enforcement Authority of Their Current Regulators**
  - Banks and thrifts with assets of $10 billion or less and credit unions with assets of $1.5 billion or less are still subject to the CFPA.
  - But examination and enforcement authority with respect to compliance with the Act, CFPA-issued regulations and other consumer financial laws and regulations will remain with current banking regulators.
  - The CFPA can recapture this authority in certain circumstances
- **Preemption of State Consumer Protection Laws for National Banks and Thrifts**. Compromise reached on preemption of state consumer protection laws would allow federal banking regulators to preempt a class of similar state laws.
  - The Comptroller of the Currency and the Director of the OTS are authorized to determine through rulemaking, and courts authorized to hold, that state laws are preempted if a state law is found to "prevent, significantly interfere with, or materially impair the ability of a national bank [or thrift] to engage in the business of banking." Determinations must be made on the basis of substantial evidence.
    - To the extent that they are substantively equivalent, state consumer protection laws can be preempted as a class with respect to all national banks and thrifts.

        - In determining whether other state laws have terms substantively equivalent to a particular law pre-empted, the Comptroller or the OTS Director must consult with the CFPA.

    - The Comptroller's or the OTS Director's preemption determinations are not delegable and are subject to less than deferential judicial review.

- **Fees**. Authorizes the CFPA to levy fees to cover the expenses of its supervision, examination and enforcement activities.

    - Smaller institutions still subject to the examination and enforcement authority of their current regulators will not be subject to assessment by the CFPA.

    - Fees will be based on an institution's size, the complexity of the risk it poses and its compliance record.

    - A nondepository institution will not be subject to assessment if the assets of and gross revenues derived by that institution are not substantially related to "financial activities," although the Director can still impose assessments if he or she determines that the institution has an "extensive" consumer financial product or services operation.

    - Assessment funds will be established separately for depository and non-depository institutions, although a nondepository institution will not be subject to lower assessments to the extent that it exhibits the characteristics of a depository institution.

- **No Private Right of Action**. Does not create any new federal private right of action, but it does not deny any private rights of action under existing state and federal consumer protection laws, including those federal private rights of action to be transferred to the CFPA from other agencies.

- **Miscellaneous**

    - The Director can issue regulations prohibiting or imposing conditions on mandatory predispute arbitration clauses.

    - The Director must issue a new rule mandating overdraft protection disclosures in consumer banks' branch offices.

    - The Director must issue new rules covering reverse mortgages, including provisions mandating certain disclosures and identifying what constitutes an "unlawful, unfair, deceptive or abusive" act or practice.

    - Private educational lenders must now secure certain certifications from prospective borrowers' schools, and will be subject to new regulations to be issued by the CFPA.

    - The CFPA's authority extends to an uninsured branch or agency of a foreign bank or a commercial lending company owned or controlled by a foreign bank.

Regulation of Advisers to Hedge Funds and Others

- **"Private Investment Adviser" and Certain Other Registration Exemptions Eliminated, Requiring Nearly All Advisers to Private Funds to Register with the SEC.** The "private investment adviser" registration exemption (fewer than 15 clients) that is currently relied on by many investment advisers, including those to private funds, is eliminated.

- Also eliminates the intrastate registration exemption for investment advisers with any private fund client and the CFTC-registered commodities trading advisor registration exemption where such commodities trading advisor is an investment adviser to a private fund.

- Permits the SEC to issue rules requiring the registration and examination of investment advisers to "mid-sized private funds" that "reflect the level of systemic risk posed by such funds."

  - The term "mid-sized private funds" is not defined.

- Requires the SEC to take into consideration the "relative risk profile" of different private funds in establishing "the registration requirements for private funds."

- A **private fund** is defined as a fund that would be an investment company under the Investment Company Act but for the exemptions for a fund with fewer than 100 investors and for a fund in which all investors are sophisticated investors known as "qualified purchasers."

- **Registration Exemptions**

  - **Venture Capital Fund Advisers.** Requires the SEC to issue a rule providing a registration exemption applicable to an investment adviser to a "venture capital fund," which the SEC must define. Such advisers would, however, be subject to recordkeeping and reporting requirements as determined by the SEC.

  - **Foreign Private Fund Advisers.** Exempts from registration an investment adviser with no place of business in the US that has, for the preceding 12 months, in total, fewer than 15 clients and investors in the US in private funds and aggregate assets under management attributable to clients and investors in the US in private funds of less than $25 million and neither holds itself out generally to the public as an investment adviser nor acts as an investment adviser to any registered investment company or business development company.

  - **Certain Private Fund Advisers.** Requires the SEC to issue a rule exempting any investment adviser that acts solely as an adviser to private funds and has assets under management in the US of less than $150 million.

    - The $150 million threshold applies to the investment adviser's cumulative assets under management rather than the assets under management of each private fund advised by the investment adviser.

    - Such advisers would, however, be subject to recordkeeping and reporting requirements as determined by the SEC.

  - **Small Business Investment Company Advisers.** Registration requirements are not triggered by the provision of investment advice by an investment adviser to licensed small business investment companies regulated by the Small Business Investment Company Act of 1958.

  - Provides that investment advisers exempt from SEC registration would still be subject to the anti-fraud provisions of the Investment Advisers Act of 1940 (the "Advisers Act").

- **Records and Reports of Private Funds.** Requires registered investment advisers to maintain records and file reports with the SEC as "necessary or appropriate in the public interest and for the protection of investors or for the assessment of systemic risk."

  - For each private fund advised by a registered investment adviser, requires the adviser to maintain or file with the SEC records detailing the private fund's assets under management; use of leverage, including off-balance sheet leverage; counterparty credit risk exposure; trading and investment positions; trading practices; and other information that the SEC and the Federal Reserve deem necessary or appropriate "in the public interest and for the protection of investors or for the assessment of systemic risk."

  - Subjects all records of a private fund maintained by an registered investment adviser to such fund to periodic and special examination by the SEC. Not limited to simply the records required to be kept by law.

- **Information Sharing and Confidentiality.** Requires the SEC to share information filed with or provided to the SEC with the Federal Reserve and the Council. Information shared to be kept confidential, except it may be disclosed to Congress, to a Federal department or agency or any self-regulatory organization for purposes within the scope of its jurisdiction, or by court order in an action brought by the US or the SEC. Information provided is explicitly carved out from FOIA disclosure.

- **Public Disclosure.** Endows the SEC with the authority to issue rules requiring registered investment advisers to provide reports, records and other documents to investors, prospective investors, counterparties and creditors of any private fund advised by that adviser. The SEC may not, however, compel the disclosure of a private fund's proprietary information to its counterparties and creditors.

- **Client Identity Disclosure.** Removes the provision that currently prohibits the SEC from requiring an investment adviser to disclose "the identity, investments or affairs of any client" except for purposes of enforcement proceedings and related investigations.

- **Joint CFTC/SEC Rulemaking.** Requires the CFTC and the SEC to issue joint rules, after consultation with the Federal Reserve, regarding the collection of systemic risk data from investment advisers registered with both agencies.

- **Qualified Client Standard Adjusted for Inflation**. Requires periodic adjustment for inflation when the SEC grants certain exemptions under the Advisers Act. The $750,000 assets under management and $1.5 million net worth tests for determining a client's status as a "qualified client" would be adjusted for inflation no later than one year after the enactment of the Act and every five years thereafter.

Changes in Broker-Dealer Regulation and Investor Protection

Broker-Dealer and Investment Adviser Regulation

- **Fiduciary Duty**. Requires the SEC to adopt rules specifying that the standard of conduct for broker-dealers shall be the same as the standard of conduct for investment advisers when providing personalized investment advice to a retail customer about securities. No continuing duty of care or loyalty to the customer after advice is provided.

- **Short Sales**. Requires institutional investment managers to provide the SEC with daily reports regarding short sales.
    - Requires SEC to issue rules for public disclosure of such information, which, at a minimum, would need to occur every month.
    - Requires broker-dealers to provide notice to customers that they may elect not to allow their fully paid securities to be used in connection with short sales (i.e., loaned by their broker).
    - Adds manipulative short selling as an unlawful activity.
- **Custody Requirements**. Requires the SEC to adopt a rule requiring investment advisers to use a qualified custodian to custody any client accounts with more than $10 million worth of client funds or securities.
    - If the SEC rule includes exceptions, the exceptions must require that at least once per year clients receive a report from an independent entity with a fiduciary responsibility to the client to verify that the assets in the client's account are in accord with those stated on the client's account statement.
- **Portfolio Margining**. Encourages portfolio margining by providing SIPC protection to futures and options on futures in portfolio margining accounts; does not resolve futures segregation obstacles.
- **Securities Lending**. Provides the SEC with explicit authority to regulate securities lending.
- **Municipal Securities**. Requires broad SEC regulation of municipal financial advisers, broadly defined as a person who provides advice for compensation to a municipal securities issuer with respect to the issuance of securities, the investment of proceeds or the selection or negotiation of investment products generally, hedging activities and the preparation of disclosure documents, among other things. There are various carve-outs, including for lawyers, credit rating agencies acting in their capacity as such, and broker-dealers acting as underwriters.
    - Reconstitutes the Municipal Securities Rulemaking Board with a majority of board members that are not affiliated with broker-dealers, municipal dealers or municipal advisors.
- **Records Maintenance Obligations for Investment Companies**. Authorizes the SEC to adopt new records maintenance obligations for persons having custody or use of a registered investment company's securities, deposits or credits, and SEC examination authority over such persons and persons with custody or use of an investment adviser's securities, deposits or credits.
- **SIPC Assessment**. Increases the minimum assessment paid by members of the Securities Investor Protection Corporation to be a percent of gross revenues from the securities business of the member.
- **SRO Rule Filing**. Streamline the process for considering self regulatory organization rule changes.
- **Investment Company Examinations**. Authorizes the SEC to conduct periodic examinations of investment companies, as well the underwriter, broker, dealer, or investment adviser of those investment companies.

- **PCAOB Review of Auditors of Broker-Dealers**. Authorizes the Public Company Accounting Oversight Board (the "PCAOB") to review 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.

    - 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.

Investor Protection

- **Extending SEC's Aiding and Abetting Authority**. With respect to the Securities Act of 1933 and the Investment Company Act of 1940, 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 split among the US Courts of Appeals.

- **Extraterritorial Jurisdiction of the Anti-fraud Provisions of the Federal Securities Laws**. In actions by the US or SEC, expands extraterritorial jurisdiction under the anti-fraud provisions of the securities laws to include "conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors" as well as "conduct occurring outside the United States that has a foreseeable substantial effect within the US."

- **Control Person Liability under the Exchange Act**. Clarifies that the SEC may impose joint and several liability on control persons.

- **SEC Authority to Restrict Mandatory Pre-dispute Arbitration.** Authorizes the SEC to consider prohibiting or limiting the use of mandatory pre-dispute arbitration agreements by broker-dealers and investment advisers. Requires a GAO study of the FINRA arbitration system.

- **SEC Authority to Issue Rules on Proxy Access**. Makes clear that the SEC has the authority to prescribe rules and regulations, including procedures, relating to the inclusion of shareholder nominees for the board of directors in a company's proxy solicitation.

- **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 an amount not exceeding 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 funded 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. Amends the Sarbanes-Oxley Act to prohibit retaliation against whistleblowers by subsidiaries or affiliates of a company.

- **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.

- **Nationwide Service of Subpoenas**. Provides that nationwide service of subpoenas is available in civil SEC actions filed in federal courts.

- **Authorize SEC to Order Penalties in Cease and Desist Proceedings**. Amends the securities acts to give the SEC uniform authority to seek civil penalties in cease and desist proceedings.

- **Clarify Authority over Formerly-associated Persons.** Makes clear that the SEC may bring suits against person formerly associated with a registered entity to prevent individuals from avoiding a penalty or bar simply because they are not longer associated with that registered entity.

- **Information Sharing with Foreign Regulators and Protection of Privileges.**

    - Amends the Sarbanes-Oxley Act to provide for the sharing of information with foreign auditor oversight authorities without waiving confidentiality or privilege.

    - Allows the SEC and domestic and foreign securities authorities and law enforcement authorities to share information without waiving any privilege applicable to that information. Prevents the SEC from being compelled to disclose privileged information obtained from a foreign securities authority or law enforcement authority, if the foreign authority represented to the SEC in good faith that the information is privileged.

- **Expanded Access to Grand Jury Material.** Permits the disclosure to the SEC by a court, upon motion by a government attorney, of matters occurring before a grand jury that relate to conduct that "may constitute a violation of any provision of the securities laws," so long as the court determines that there is a "substantial need in the public interest."

- **Exemption for Nonaccelerated Filers.** Removes the requirement that an auditor attest to internal controls for any issuer that is not an accelerated filer. Commissions a study to determine how the SEC can reduce the costs of complying with the auditor attestation requirement for companies with a market capitalization between $75,000,000 and $200,000,000.

- **Enhanced Application of Anti-fraud Provisions**. Expands the Exchange Act market manipulation and short sales authority.

    - Extends Section 9, which relates to market manipulation, and 10(a)(1), which relates to short sales, to cover any security "other than a government security," rather than just securities "registered on a national securities exchange."

    - Extends Section 9(b), which relates to options, to non-exchange transactions in options.

    - Amends Section 9(c) to subject all brokers and dealers to the provision, not just "member[s] of a national securities exchange."

    - Amends Section 15(c)(1)(A) to cover exchange transactions, not just over-the-counter transactions.

- **Commission Funding and Organization**. Authorizes additional appropriations for the SEC until 2015. Requires rulemaking in order to collect fees from investment advisers to pay for costs of inspections and examinations.

    - Requires a study by an independent consultant of the organizational structure of the SEC.

- Establishes the Capital Markets Safety Board to conduct investigations of failed institutions to determine the reason for their failure.

- Requires a study by the SEC of post-Madoff reforms.

- Authorizes the formation of a joint advisory committee composed of SEC members and industry experts to develop solutions to issues in the securities markets and indentify emerging regulatory risks.

- **Deadline for Completing Examinations, Inspections and Enforcement Actions**. The SEC must file an enforcement action no later than 180 days after it has provided any person with a written "Wells" notification. The SEC must inform the subject of an examination that the examination has concluded without findings or request the entity undertake corrective action within 180 days from when the SEC completes the on-site portion of an examination or inspection. In both instances there is a 180 day extension for complex matters.

- **Expansion of Audit Information to be Produced and Exchanged with Foreign Counterparts**. Provides that a foreign public accounting firm must, if requested, produce its audit work papers to the SEC and PCAOB if it "issues an audit report, performs audit work, conducts interim reviews, or performs material services upon which a registered public accounting firm relies."

  - Provides that any registered public accounting firm that relies on the work of a foreign public accounting firm in issuing an audit or interim review must produce the foreign firm's audit work papers, if asked, and secure the agreement of the foreign firm that it will cooperate as a condition of such reliance.

- **Fair Fund Amendments**. Allows the SEC to add civil penalty payments to a fund for distribution to the victims of a securities law violation regardless of whether the SEC also obtains disgorgement against the violator, as is required by current law.

- **Congressional Access to Information**. Clarifies that the PCAOB must provide access to records under the Right to Financial Privacy Act and provide Congress or a court with information.

- **Creation of an Ombudsman for the PCAOB**. Creates an ombudsman who acts as a liaison between the PCAOB and private firms and assures that complainants come forward.

- **Senior Investment 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.

- **Investor Advisory Committee**. Establishes an Investor Advisory Committee within the SEC to advise and consult with SEC on regulatory priorities and initiatives to protect investors and promote investor confidence in the integrity of the marketplace. Members of the Committee are appointed by the SEC Chairman, and must represent the interests of individual investors and institutional investors, and use a wide range of investment approaches.

- **Consumer testing**. Clarifies the SEC's authority to engage in consumer testing.

- **Studies**. Requires studies on the following subjects by the agency noted in parentheses: Disclosure to retail customers before the purchase of products or services (SEC); Enhancing investment adviser examinations (SEC); Financial planning (GAO); SEC "revolving door" (GAO); Internal control and evaluation for smaller issuers (GAO); the feasibility of risk-based assessments for SIPC members (GAO); FINRA arbitration.

Securities Holding Companies

- Applies to any non-bank securities company with European Union operations and abolishes the voluntary SEC regime

- **Mandatory Registration.** Requires registration with the Federal Reserve by a securities holding company required by a foreign regulator or foreign law to be subject to comprehensive consolidated supervision. Captures any company that owns a broker-dealer but does not already have an appropriate federal banking agency engaging in comprehensive supervision.

- **Capital and Risk Management.** Requires the Federal Reserve to prescribe capital adequacy and other risk management standards for supervised securities holding companies, taking into account differences among types of business activities and other enumerated factors. The Federal Reserve is permitted to differentiate among supervised securities holding companies on an individual basis or by category.

- **Examination and Record Keeping**. Permits the Federal Reserve to examine a supervised securities holding company and any affiliate to carry out the purposes of the section and to monitor compliance. Provides deference to other examinations. Also permits Federal Reserve to impose record keeping requirements.

- **Bank Holding Company Act Application.** Except as the Federal Reserve provides by regulation or order, subjects supervised securities holding companies to the provisions of the Bank Holding Company Act except for Section 4 activities restrictions.

- **Enforcement Under Federal Deposit Insurance Act.** Designates the Federal Reserve as the appropriate Federal banking agency for the supervised securities holding company and its subsidiaries, and applies certain provisions of section 8 of the Federal Deposit Insurance Act to the supervised securities holding company and its subsidiaries.

Limits on Federal Reserve

GAO Audit and Report of the Federal Reserve

- Requires GAO audit of the Federal Reserve Board of Governors and Federal Reserve Banks within 1 year of the passage of the Act. This is the Ron Paul (R-TX) provision that had over 300 sponsors.

- **Expands the scope of GAO audits**. Removes the limitation on GAO audits with respect to monetary policy deliberations and operations, including open market and discount window operations, transactions made under the direction of the Federal Open Markets Committee, and transactions with or for foreign central banks, foreign governments and public international financing organization from GAO audits.

    - Requires a 180-day lag period between GAO's release of records related to individual market actions and such actions.

    - Excludes unreleased transcripts or minutes of Federal Reserve Board of Governors or Federal Open Market Committee meetings.

Emergency Lending

- **FDIC Guarantees.** Upon a financial distress determination by the Council, and with the consent of the Treasury Secretary, the FDIC can create a widely-available program to guarantee obligations of solvent banks, bank holding companies or affiliates, if necessary to prevent financial instability during times of severe economic distress.
    - The FDIC can require collateral for any such guarantee.
    - The maximum guaranteed debt amount would be $500 billion, subject to increased authority in exceptional circumstances.
    - The program would be funded solely by fees on participants.
    - The period for any such program would expire at the end of December 2013.
    - **Involuntary Bankruptcy or Resolution Authority**. In the event of a default on an FDIC-guaranteed obligation, the FDIC could appoint itself as receiver of the bank that defaults, or invoke resolution authority or involuntary bankruptcy with respect to non-bank defaulting entities.
    - **Priority for Payments due to the FDIC**. Amends the Federal Deposit Insurance Act so an obligation to the FDIC as a result of a default on FDIC-guaranteed debt would rank next in priority after deposit liabilities and higher in priority than other liabilities of the institution.
- **Limits Federal Reserve Emergency Lending Authority**
    - **Limited to Broadly Available Facilities**. Lending must be part of a broadly available credit or other facility and can no longer be exclusively to a single or specific individual, partner or corporation. Limits borrowing to $4 trillion.
    - **Lending Conditions.** Borrowing cannot be secured by low-quality assets, and Federal Reserve must obtain evidence that the borrower is unable to find adequate credit accommodations from the private sector. Borrowing cannot exceed $4 trillion.
    - **Procedural Hurdles.** Requires 2/3 of the Council and written consent by the Treasury Secretary that a destabilizing liquidity event exists, and requires a finding by each Federal Reserve Board member voting to approve emergency financing and the Treasury Secretary that there is a 99% likelihood of repayment of all funds put at risk and the interest thereon. Exercise of emergency lending power triggers Congressional consideration of a joint resolution of disapproval.

Additional Oversight of Financial Regulatory System

- **Council.** Establishes a Council of Inspectors General on Financial Oversight, comprised of heads of Federal Reserve Board, CFTC, HUD, Treasury, FDIC, FHFA, NCUA, SEC and TARP to address concerns that apply to the broader financial sector and ways to improve financial oversight. Requires annual report to be submitted to Congress.

- **Restricted Open Market Activities with Respect to Foreign Currency Swaps**. Prevents a Federal Reserve Bank from engaging in open market activities with respect to foreign currency swaps unless the activity is approved by five or more members of the Federal Reserve Board and with the written concurrence of the Treasury Secretary.

Executive Compensation and Corporate Governance

- **Annual Non-binding Shareholder Approval of Executive Compensation**. At any annual meeting of shareholders, or special meeting in lieu thereof, occurring after six months after the SEC's issuance of final rules implementing the Act, companies must provide shareholders with an annual non-binding vote to approve the compensation of executives as disclosed pursuant to the SEC rules.

- **Non-binding shareholder vote on golden parachute policy**. At any meeting of shareholders where shareholders are asked to approve an M&A transaction that occurs after six months after the SEC's issuance of final rules implementing this provision, companies must provide shareholders with a non-binding vote to approve payments to any named executive officer in connection with such M&A transaction.

- **Compensation Committee Independence**. Listed companies must have compensation committees consisting of independent directors, meaning that members may not receive any consulting, advisory or other non-director compensatory fee from the issuer.

    - 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 its compensation consultants and other advisors.

    - Companies are required to disclose whether the compensation committee retained a consultant.

    - The SEC is directed to undertake a study of the use of compensation consultants within two years after issuance of its final rules implementing this provision.

- **Compensation at Financial Institutions**. Covered financial institutions with assets of at least $1 billion must disclose to the appropriate Federal regulator the structures of all incentive-based compensation arrangements.

    - Disclosure must allow regulators to determine whether structures are aligned with sound risk management and do not have serious adverse effects on economic conditions or financial stability.

- Prohibition against any incentive-based payment arrangements that regulators determine encourage inappropriate risks.

- Violation of these compensation provisions will be treated as a violation of the Gramm-Leach-Bliley Act.

- Regulators to issue regulations under these compensation provisions within 9 months of enactment.

Credit Rating Agencies

- **Registration of all Credit Rating Agencies**

  - All credit rating agencies must register as nationally recognized statistical rating organizations ("credit rating agency") by filing, rather than furnishing, an application with the SEC.

  - Registration exemption available to any credit rating agency that does not provide credit ratings to issuers for a fee and issues credit ratings only in certain publications of general and regular circulation. SEC may provide other registration exemptions.

  - The SEC must establish fines and other penalties for violations by registered credit rating agencies of applicable laws.

- **SEC Annual Review.** The SEC must, at least annually, examine each registered credit rating agency's ratings, policies, procedures, and methodologies to review whether the credit rating agency has established and adheres to a system of internal controls, due diligence and implementation of methodologies for determining credit ratings and whether the credit rating agency's required public disclosures are consistent with such system.

- **Disclosure Requirements**

  - **To the credit rating agency by the sponsor:**

    - SEC disclosure rules to specify the information required to be disclosed to the credit rating agency by the sponsor, issuer and underwriter with respect to the collateral underlying structured securities.

  - **To the public by the credit rating agency:**

    - SEC disclosure rules to require procedures to collect and disclose information about how the sponsor, issuer and underwriter of structured securities assess the accuracy and integrity of their data.

    - Credit rating agencies must maintain a public website to disclose historical default rates for all classes of rated financial products.

    - Credit rating agencies must publicly and for free disclose performance information on initial ratings and subsequent changes to enable investors to compare performance across credit rating agencies.

    - Attestation accompanying each credit rating issued affirming no influence by the credit rating agency's other business activities.

        - Disclosure of ratings histories provided to the SEC in EDGAR-consistent format.
        - Credit rating agencies must include an extensive disclosure form with the publication of each credit rating.
    - **To the public by the issuer:**
        - Disclosure of preliminary ratings received from a credit rating agency.
        - Disclosure by an issuer of information to the credit rating agency is no longer exempt from Regulation FD.
- **Enforcement and Liability**
    - **Penalties for Certain Actions.** Expands specified misconduct to which certain penalties apply to include ratings surveillance failures and includes fines within such penalties.
    - **Private Right of Action Against Credit Rating Agencies**
        - Clarifies that credit rating agencies can be sued under private rights of action.
        - Establishes gross negligence as the requisite state of mind for private securities actions against credit rating agencies for money damages.
        - Provides that a purchaser of a rated security has a right to recover damages if the process of determining the rating was both grossly negligent and a substantial factor in the investor's economic loss.
    - **Expert Liability.** Renders credit rating agencies experts subject to Securities Act liability in the same manner as accountants when ratings are included in a registration statement and requires the credit rating agency's consent for such inclusion.
- **Voluntary Withdrawal of Registration.** Permits voluntary withdrawal of registration only if the credit rating agency received less than $250,000 in net ratings revenue during its last full fiscal year.
- **Conflicts of Interest**
    - Requires a credit rating agency to establish, maintain and enforce written policies and procedures reasonably designed to address, manage, and disclose any conflicts of interest that can arise from its business. Provides for SEC review of such policies.
    - Sets extensive conflicts of interest guidelines, including certain revenue disclosure, employment look-back policies, and a prohibition on certain non-rating products or services.

- **Ratings Rules**
  - Requires credit rating agencies to establish, maintain, and enforce written procedures and methodologies and an internal control system reasonably designed to achieve specified goals.
  - Permits SEC to require credit rating agencies to establish rating symbols that distinguish structured product ratings from others.
  - Requires SEC to issue rules to require credit rating agencies to establish, maintain and enforce written policies and procedures to ensure that ratings are clear and consistent.
  - Requires a written certification from any third-party due diligence service provider used in connection with a rating action.
- **Removes Statutory References to Credit Ratings.** Requires the removal of numerous statutory references to credit ratings and requires agencies to modify regulations to remove references to or reliance upon credit ratings and substitute an alternative standard of credit-worthiness.
- **Credit Rating Agencies' Organizational Structure**
  - **Board of Directors.** Each credit rating agency must have a board of directors with independent directors comprising 1/3 of the board (no fewer than 2) with specified oversight responsibility.
  - **Compliance Officer.** Each credit rating agency must designate a compliance officer with specified responsibilities, including direct reporting to the board of directors and submission of an annual report, certified as accurate and complete, to the SEC.
- **SEC Organizational Structure**
  - **SEC Credit Ratings Office**. The SEC must establish an office of sufficient size to administer SEC rules with respect to the practices of credit rating agencies.
  - **SEC Credit Ratings Agency Advisory Board**. The SEC must establish a 7-member Credit Ratings Agency Advisory Board to advise the SEC concerning required rules and ensure that the SEC properly and fully executes its oversight responsibilities.
- **Studies and Reports.** Requires numerous SEC and GAO studies.

Increase in FDIC Fees

- **FDIC Fee Assessment**. Requires FDIC to base deposit insurance fees on an insured depository institution's ***total assets less equity***, rather than on its deposits. The move to assets as a base, rather than deposits, favors smaller banks.
- Directs the FDIC to adopt a risk-based assessment and sets forth factors to be taken into account, including off-balance sheet liabilities of the insured depository institution and its affiliates
- Permits the FDIC, in its sole discretion, to suspend dividends of excess amounts in the deposit insurance fund when the reserve ratio exceeds 1.5% of estimated insured deposits.

- Requires the FDIC to make public the reserve ratio and designated reserve ratio within 5 years

Asset-Backed Securities

- Adopts skin-in-the-game requirements for creditors and encourages heightened underwriting, risk management and disclosure practices in the asset securitization area. Also applies to securitizers of asset-backed securities that are backed by assets other than loans that are covered by the Act.

- **Skin-in-the-game**. There is a 5% retention requirement for loans transferred, sold, or conveyed to a third party. Regulators are be permitted to create exceptions, up or down, to this amount.

- **No Hedging**. The asset originator or securitizer cannot hedge the required retained credit risk.

- **Regulation**. The SEC, the Federal banking agencies, the National Credit Union Administration Board, the Secretary of Housing and Urban Development, the Federal Housing Agency, or the Rural Housing Service will determine the types of credit retention allowed and the duration required, depending on the type of asset.

- **Exemptions**. Loans insured, guaranteed or administered by the Secretary of Education, Secretary of Agriculture, Secretary of Veterans affairs, or the Small Business Administration, or made, insured, guaranteed, or purchase by any person that is subject to the supervision of the Farm Credit Administration, are excluded from the Act.

- **Reporting**. Asset-backed securities are removed from the exemption from Exchange Act filing requirements for securities held by fewer than 300 persons. Regulation AB applies in full.

    - Disclosure is required of tranche-, class-, security-, asset- and loan-level data to allow for independent due diligence.

- **Representations and Warranties**. Credit rating agencies are required to include in reports accompanying credit ratings a description of the representations and warranties for the issuance. Disclosure is also required regarding fulfilled repurchase requests, so underwriting deficiencies are clear.

- **Removal of Exemption from Registration**. The exemption for certain specific categories of mortgage backed securities provided by Section 4 would be deleted.

Insurance

Federal Insurance Office

- **Establishes Federal Insurance Office.** Creates a Federal Insurance Office within Treasury. The FIO will have a Director appointed by the Treasury Secretary, who will also be an advisory member of the Council.

    - **Duties.** In addition to any other assigned duties, the FIO would monitor the insurance industry and identify regulatory gaps, recommend to the Council 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.

- **Information-gathering Powers.** FIO may actively request information from any insurer or affiliate of an insurer, with an exception for small insurers. In addition, power only applies to entities that write insurance or reinsurance in one or more states. Does not grant the FIO subpoena power.

- **Preemption.** Grants the FIO limited power to preempt any state insurance regulation that directly results in less favorable treatment of a non-US insurer than a US insurer authorized in that state and that is inconsistent with a covered agreement.

  - Power reaches "covered agreements," which must be written agreements between the US and foreign government/regulatory entities. They must "achieve[] a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under [state regulation]."

    - State capital/solvency requirements are exempt unless they have a direct less favorable effect on a foreign insurer.

- *De novo* judicial review, not *Chevron* deference, for FIO findings of inconsistency.

- Before making any determination, Director must consult with the state and notify the US Trade Representative.

- **International Trade Authority.** Authorizes Treasury Secretary and US Trade Representative, after consultation with Congress, to enter into agreements "covered" for purposes of preempting state measures. Measures must be submitted to Congress at least 90 days before taking effect. Savings provision specifies that this title of the Act will not be construed to affect development of US trade policy.

- **Reports.** FIO must report to Congress on (i) modernizing and improving US insurance regulation and (ii) the role of the global reinsurance market in supporting insurance in the US.

Regulation of Nonadmitted Insurance

- **Preemption of Conflicting State Law on Nonadmitted Insurance.** Limits state regulatory authority with respect to nonadmitted insurance, defined to apply to P&C insurance, strictly to the home state of the insured, except with respect to certain workers compensation coverages. State laws that do not comply with the following will be preempted:

  - Prohibits states from imposing eligibility requirements on nonadmitted insurers domiciled in a US jurisdiction except in conformance with the criteria set forth in the NAIC model law or otherwise developed to be consistent across states,

  - Prohibits 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

  - Eliminates state prohibitions on surplus lines brokers procuring insurance from nonadmitted insurers domiciled outside the US and included on an NAIC list.

- **Premium Tax.** Prohibits states, other than home state of the insured, from requiring premium tax payments for nonadmitted insurance. Encourages the development of an interstate compact for payment, collection and allocation of such taxes.

- **Brokers Need Not Comply with State Diligence Requirements with respect to Sophisticated Parties**. With respect to "exempt commercial purchasers" who request coverage from nonadmitted insurers, the Act eliminates state requirements that surplus lines brokers undertake diligence searches to determine whether coverage can be obtained from admitted insurers.

- **Comptroller General Study**. Must conduct a study to determine effect of legislation on the nonadmitted insurance market.

Regulation of Credit for Reinsurance

- **Requires Recognition of Credit for Reinsurance**. Prohibits a state from denying credit for reinsurance if the ceding insurer's (i.e. the party that purchases reinsurance) state of domicile recognizes such credit.

- **Preemption**. Preempts state laws that restrict arbitration rights, dictate choice of law governing reinsurance contracts, attempts to enforce reinsurance contracts on different terms, or otherwise applies state law to reinsurance agreements of ceding insurers outside that state.

- **State of Domicile Controls a Reinsurer's Solvency Requirements**. Reserves the sole responsibility of regulating a reinsurer's financial solvency to its state of domicile if the home state is NAIC-accredited, **or** has requirements substantially similar to those necessary for accreditation.

- **State of Domicile Controls a Reinsurer's Financial Information Obligations.** Prohibits a state from requiring a reinsurer to provide financial information other than that which it is required to file with its domiciliary state.

- **Subtitle does not supersede antitrust laws.**

Mortgage-Related Provisions

- **Mortgage Reform and Anti-Predatory Lending Act.** Among other things, sets minimum standards for mortgages, heightens regulation over mortgage originators and regulates mortgage servicing, appraisal activities. Includes a sense of Congress for the importance of meaningful structural reforms of GSEs.

- **Foreclosure Avoidance and Affordable Housing.** Among other things, permits the Treasury to transfer $3 billion of TARP funds to the Emergency Homeowner's relief fund and $1 billion for the Neighborhood Stabilization Program.

- **Public Availability of Home Affordable Modification Program Data**. Requires mortgage lenders and servicers to make public information relating to mortgage modifications. Also requires each mortgage servicer participating in the program to provide each borrower under a mortgage whose request for mortgage modification is denied with all borrower and mortgage related input data used in any net present value analysis performed in connection with the mortgage. Formulae for calculating net present value to be made publicly available.

References

Wall Street Reform and Consumer Protection Act

HR 4173: Wall Street Reform and Consumer Protection Act
Introduced in the House of Representatives on December 2, 2009

Davis Polk Chart of Amendments to the Wall Street Reform and Consumer Protection Act Since Introduction on the House Floor (December 11, 2009)

Davis Polk Related Memoranda

The House and Senate Debate Resolution Authority (November 12, 2009)

Dodd Bill Would Affect Corporate Governance and Executive Compensation Processes for All US Public Companies (November 17, 2009)

Summary of the Restoring American Financial Stability Act of 2009, Introduced by Senator Christopher Dodd (D-CT) November 10, 2009 Discussion Draft (November 13, 2009)

Investment Management Regulatory Update: House Financial Services Committee Approves Private Fund Investment Advisers Registration Act (November 11, 2009)

Investor Protection Act Passes House Financial Services Committee (November 9, 2009)

Consumer Financial Protection Agency Act Clears House Financial Services Committee (October 28, 2009)

The Regulatory Reform Marathon (July 28, 2009)

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