



Summary of the March 15, 2010
Draft of the Restoring American Financial Stability Act,
Introduced by Senator Christopher Dodd (D-CT)

March 17, 2010

Notice: This is a summary that we believe may be of interest to you for general information. It is not a full analysis of the matters presented and should not be relied upon as legal advice. If you have any questions about the matters covered in this publication, the names and office locations of all of our partners appear on our website, davispolk.com.

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I. Institutional Arrangements

- **Financial Stability Oversight Council.** Interagency Council, consisting of 9 voting members – the Treasury Secretary (Chairperson) and the heads of Fed, OCC, Bureau of Consumer Financial Protection (Consumer Bureau), SEC, FDIC, CFTC, FHFA, and independent member with insurance expertise named by President and confirmed by Senate.
 - **New Office of Financial Research.** Provides analytical support to Council. Director is non-voting observer on Council.
 - **Systemic Designations.** Council empowered to identify “systemically important” financial companies and activities, financial market utilities and payment, clearance and settlement activities. Only nonbank financial companies must be identified as systemically important to be subject to “enhanced” prudential standards, while “large, interconnected” bank holding companies (as determined by Fed?) would be subject to enhanced prudential standards without such Council determination.
 - **Consultation.** Council would be required to consult only with primary financial regulatory agencies, rather than with both the Fed and such agencies as under the House bill.
 - **Monitoring, Reports.** Council to identify risks to financial stability, promote market discipline, and respond to emerging threats to U.S. financial markets. To serve these purposes, Council to engage in data gathering, information sharing, monitoring, and identification of gaps in regulation, among other things. Can require reports from any bank holding company or nonbank financial company to assess threats from an activity, market, or the company itself, and certified reports from systemically important companies.
 - **Fed Supervision.** Fed to supervise nonbank financial companies identified as systemically important by the Council.
- **Banking Agency Reorganization**
 - **OTS and the Thrift Charter.** Abolishes OTS and terminates the power to grant new thrift charters, unlike the House bill, which maintains the thrift charter but creates a Division of Thrift Supervision at the OCC.
 - **Reallocation of Powers among Fed, OCC and FDIC**
 - **Fed:** Rulemaking authority over all bank and thrift holding companies and supervisory authority over bank and thrift holding companies with assets of \$50 billion or more and their non-depository institution subs. Rulemaking authority under the Federal Reserve Act for state member banks, and rulemaking authority relating to thrift transactions with affiliates and loans to insiders.
 - Loses supervisory authority over state member banks.
 - Must consult with FDIC and OCC before proposing or adopting regulations that apply to bank holding companies and thrift holding companies having less than \$50 billion in assets.
 - **OCC:** Gains supervisory authority over all federal thrifts, rulemaking authority over thrifts other than as retained by the Fed, and supervisory authority over bank and thrift holding companies with assets of less than \$50 billion and their non-depository institution subs, where majority of assets held by depository institution subs are held by federally chartered depository institutions.

- Must consult with the FDIC before proposing or adopting regulations that apply to state thrifts.
- **FDIC:** Gains supervisory authority over all insured state chartered banks and thrifts, *including state member banks*, rulemaking authority over insured state-chartered banks (other than as retained by the Fed under the Federal Reserve Act), and supervisory authority over bank and thrift holding companies with assets of less than \$50 billion and their non-depository institution subs, where majority of assets held by depository institution subsidiaries are held by state-chartered depository institutions.
- **FDIC Board – Consumer Bureau takes OTS Seat.** Assigns OTS Director’s seat on the FDIC board to the director of the Consumer Bureau, not the Fed Chairman as in the House bill.

II. Systemic Regulation

Increased Capital, Liquidity and Other Requirements

- **Applicability of Standards.** Fed required to impose “enhanced” prudential standards on “systemically important” nonbank financial companies, as well as “large, interconnected” bank holding companies.
 - Firms must be substantially engaged in financial activities (as defined by Fed) to qualify as nonbank financial companies. Intent is not to consider commercial companies, such as manufacturers, retailers and others, as nonbank financial companies generally.
 - **2/3 Council Vote, Registration.** For nonbank financial companies, designation as systemically important requires vote of at least 2/3 of Council (including affirmative vote of the Chairperson). Once designated, systemically important nonbank financial companies must register with the Fed within 180 days. Registration is designed to collect information needed to carry out systemic regulation.
 - Nonbank financial companies entitled to notice and opportunity for hearing before final determination.
 - Judicial review of designation as systemically important available, conducted under “arbitrary and capricious” standard.
 - Reevaluation of systemically important designation not less frequently than annually; rescission has same voting requirements as designation.
 - **Large Bank Holding Company Threshold.** Bank holding companies must have at least \$50 billion in assets for enhanced standards to apply. Fed has authority to raise – but not lower – the threshold.
- **“Enhanced” Prudential Standards Include:**
 - **Required Standards.** Fed must establish stricter risk-based capital requirements, leverage limits, and liquidity requirements; require resolution plan and credit exposure reporting, and impose concentration limits.
 - **Limits on Credit Exposures to Non-Affiliates.** Concentration limits must prohibit credit exposure to any unaffiliated company that exceeds 25 percent of capital stock and surplus (or such lower amount as the Fed may prescribe by regulation).
 - **Direction to Customize Standards.** Standards to increase in stringency, to take into account differences among nonbank financial companies and bank holding companies, and

to ensure to the extent possible that small changes in factors used to designate systemically important companies do not result in sharp, discontinuous changes in the standards.

- **Discretionary Standards.** Fed may, but is not required to, establish overall risk management requirements and enhanced public disclosures.
- **Absence of Certain Statutory Mandates.** Unlike House bill, there is no mandatory leverage limit, no specific Fed authority to limit short-term debt, and no mandate to make capital requirements counter-cyclical or include off-balance sheet items in capital ratios.
- **Contingent Capital.** Fed is permitted to require contingent capital, but only after a Council study and subsequent report to Congress.
- **Risk Committees at Public Companies.** Requires risk committees for systemically important, publicly traded nonbank financial companies, as well as publicly traded bank holding companies with total consolidated assets of \$10 billion or more.
- **Stress Tests.** Requires stress tests to be conducted by the Fed but does not specify frequency.
- **Prompt Corrective Action.** Requires Fed, in consultation with the Council and FDIC, to establish requirements for early remediation of financial distress, unlike House bill, which sets forth detailed prompt corrective action standards.
- **Reports, Examinations and Enforcement Regarding Nonbank Companies.** Subjects systemically important nonbank financial companies and their subsidiaries to reporting requirements, examination by, and enforcement powers of the Fed. For depository institutions or functionally regulated subsidiaries, Fed can recommend action or enforcement proceeding to primary financial regulator.
- **Management Interlock Prohibition.** Systemically important nonbank companies are subject to prohibition on management interlocks as if they were bank holding companies, and Fed cannot by regulation permit management interlocks between systemically important companies.
- **Exemptions.** Fed, on behalf of and in consultation with Council, directed to establish criteria for exempting “types or classes” of nonbank financial companies from enhanced Fed supervision.
- **No Intermediate Holding Company Requirement.** No requirement that systemically important nonbank financial companies segregate their financial activities from their commercial activities through an intermediate holding company or comply with restrictions on transactions between the financial and commercial arms, but Fed granted discretion to impose such requirements and restrictions. No requirement for systemically important nonbank financial companies to conform to Section 4 of the BHC Act.

Standards and Safeguards for Systemically Important Activities and Practices

- Allows new or heightened prudential standards or safeguards to be set for particular financial activities or practices for all bank holding companies and nonbank financial companies, whether or not institutions are individually designated as systemically important. Standards to take long-term economic growth into account and may prescribe the conduct or prohibit the activity or practice.

M&A Activity

- **Bank Acquisitions.** Systemically important nonbank financial companies are subject to limits on bank acquisitions as if they were bank holding companies.
- **Large Nonbank Acquisitions.** Both bank holding companies with assets of \$50 billion or more and systemically important nonbank financial companies must obtain prior Fed approval to acquire

companies with consolidated assets of \$10 billion or more engaged in financial activities made permissible by the Gramm-Leach-Bliley Act other than securities underwriting, dealing, or market-making.

Activities Restrictions, Asset Sales and Breakup Powers

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

“Hotel California” Provision (De-banking)

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

Living Wills/Funeral Plans

- **Requirement.** Requires systemically important nonbank financial companies and large, interconnected bank holding companies to prepare and maintain extensive rapid and orderly resolution plans, which must be approved by the Fed and the FDIC. Imposes penalties on such firms for failing to adopt acceptable plans.

Systemic Regulator Fees Unlike the House bill, establishes a Financial Research Fund that would assess systemically important companies to defray the costs of the Office of Financial Research (which include costs of the Council).

Foreign Financial Companies

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

III. Bank Holding Company Act Amendments

Volcker Rule

- **Activities Restrictions**
 - **Prohibition on Proprietary Trading and Investing in or Sponsoring Certain Private Funds.** Unless excused by Council, appropriate Federal banking agencies are required to issue rules prohibiting certain companies from engaging in proprietary trading or investing in or sponsoring hedge funds or private equity funds.
 - **Exemptions from Ban on Proprietary Trading.** Includes exemptions for:
 - **Customer Related Trading.** Trading "on behalf of a customer, as part of market making activities, or otherwise in connection with or in facilitation of customer relationships, including [related] hedging activities."

- **Government Obligations.** Trading in obligations issued or guaranteed by the U.S. government or its agencies, certain GSE securities, and state and municipal obligations.
- **Foreign Trading by Foreign Companies.** Trading by a foreign company pursuant to Sections 4(c)(9) or 4(c)(13) of the BHC Act “solely outside the United States,” provided the company is not controlled by a U.S. domestic parent.
- **Exemption from Ban on Investing in or Sponsoring Certain Private Funds.** An investment or activity conducted by a foreign company pursuant to Sections 4(c)(9) or 4(c)(13) of BHC Act “solely outside the United States,” provided the company is not controlled by a U.S. domestic parent.
 - **No Exemption for Customer-Driven Fund Activity.** No exemption for investing in or sponsoring hedge funds or private equity funds where the covered company shows that such activities are in connection with or in facilitation of customer relationships or designed to serve the needs of customers.
- **No Exemptions for Trading in Certain Bank-Eligible Instruments.** No exemption for proprietary trading in other bank-eligible instruments such as OTC or exchange-traded contracts for foreign exchange, interest rates or bullion.
- **No General Exemptive Authority.** Agencies would not have any general authority to grant exemptions from the prohibitions, such as making distinctions between proprietary trading in other highly liquid financial instruments in contrast to illiquid and opaque instruments or investing in or sponsoring hedge funds or private equity funds that are in connection with or in facilitation of customer relationships or otherwise to serve customer needs.
- **Covered Companies.** Prohibitions would apply to insured depository institutions, their holding companies, any company treated as a bank holding company for purposes of the BHC Act (e.g., a foreign bank within a U.S. commercial banking presence) and any of their subsidiaries, *including broker-dealer and fund manager subsidiaries*.
 - **Competitive Advantage for Foreign Companies.** Volcker Rule would create a competitive advantage for foreign financial companies, which could engage in proprietary trading and investing and sponsoring hedge funds and private equity funds off-shore. Foreign nonbank financial companies that do not have systemically important operations in the United States and are not otherwise treated as bank holding companies could conduct such activities inside the United States without being subject to the additional capital requirements or other quantitative limits.
- **Sponsoring.** Defined as serving as a general partner, managing member or trustee of a fund; selecting or controlling a majority of the directors, trustees or management of the fund; or sharing the same name or a variation of the same name with a fund.
- **Council Study.** Council required to complete a study of the activities limits of the Volcker Rule within 6 months of its enactment and make recommendations regarding their implementation, including any “modifications” to their definitions, prohibitions, requirements, and limitations that would “more effectively implement the purposes” of the activities limits.
 - **Council Study – Little More Than Window Dressing.** Volcker Rule activity limits appear inevitable if included in final Dodd bill as written despite Council study requirement. Council is not given authority to reject basic elements of Volcker Rule activity limits. Its authority is limited to “modifications” that would “more effectively implement the purposes” of the activity limits of the Volcker Rule and the Supreme Court has previously interpreted the word “modify” to be limited to “moderate change.”

- **Rulemaking.** The appropriate Federal banking agencies would be required to issue final rules implementing the activity limits of the Volcker Rule in light of the Council's recommendations within 9 months after the completion of the study.
- **Limitations on Transactions with "Advised" Private Funds.** Outright ban on Section 23A "covered transactions" between covered company and private equity or hedge funds advised by a covered company. Other transactions between such companies and funds subject to Section 23B "market terms" requirements as if covered company were "member bank" and fund were its "affiliate."
- **Capital and Quantitative Limits on Nonbank Financial Companies.** Fed required to impose additional capital requirements and quantitative limits on systemically important nonbank financial companies, presumably including systemically important hedge funds, that engage in proprietary trading or investing or sponsoring private equity or hedge funds.
 - Depending on how those additional requirements or limits are defined, they could amount to an effective prohibition on these activities by making them too costly.
- **Transition Period.** Covered companies would have 2 years from the date of any final regulations to conform their activities to the Volcker Rule, subject to up to three 1-year extensions at the discretion of any such company's appropriate Federal banking agency.
- **Concentration Limits**
 - **Liability Cap.** Prohibits any "financial company" from merging with or acquiring substantially all of the assets or control of another company if the resulting company's total consolidated liabilities would exceed 10 percent of the aggregate consolidated liabilities of all financial companies at the end of the prior calendar year.
 - **Council Study.** Council required to complete a study of the concentration limits of the Volcker Rule within 6 months of its enactment and make recommendations regarding their implementation, including any "modifications" to their definitions, prohibitions, requirements, and limitations that would "more effectively implement the purposes" of the concentration limits in the Volcker Rule.
 - **Council Study – Little More Than Window Dressing.** Volcker Rule concentration limits may be largely inevitable if included in final Dodd bill as written despite Council study requirement.
 - **Rulemaking.** The appropriate Federal banking agencies would be required to issue final rules implementing the concentration limits of the Volcker Rule in light of the Council's recommendations within 9 months after the completion of the study.

Regulation of Bank Holding Companies

- **Regulation of Functionally Regulated Subsidiaries of Bank Holding Companies.** Allows the appropriate Federal banking agency to examine, monitor, and enforce compliance of bank and thrift holding companies and their functionally regulated subsidiaries with the Act and with any other Federal law that the appropriate Federal banking agency has jurisdiction to enforce.
 - **Appropriate Federal Banking Agency.** Defined as the Comptroller of the Currency, the Fed Board, the FDIC or the Director of the OTC, as applicable.
 - **Functionally Regulated Subsidiary.** Defined as any bank holding company subsidiary (except a bank holding company or a depository institution) that is a broker dealer, investment company, investment advisor, insurance company or a futures commission merchant, commodity trading advisor or commodity pool operator.

- **Holding Company Level Capital and Management Requirements.** As in House bill, financial holding companies must be well-capitalized and well-managed on a consolidated basis at the holding company level as well as at the depository institution level.
- **M&A Limits**
 - **New Financial Stability Factor.** Requires Fed to consider impact of acquisitions on U.S. financial stability in approving or disapproving proposed bank and nonbank acquisitions.
 - **New Prior Approval Requirement for Large Nonbanking Acquisitions by FHCs.** Requires all financial holding companies to obtain prior Fed approval before acquiring a financial company with assets of \$25 billion or more.
 - **New Capital Requirements for Interstate Bank Acquisitions.** To make an interstate bank acquisition, acquiring bank must be well capitalized and well managed, not merely adequately capitalized and adequately managed, and the resulting bank must be well capitalized and well managed upon consummation of the transaction.

Source of Strength

- Companies that directly or indirectly control an insured depository institution (*i.e.*, all depository institution holding companies, including commercial companies that own industrial banks or industrial loan companies or are grandfathered thrift holding companies) are statutorily required to serve as a source of strength for the institution. The requirement is no longer discretionary, as in the November Dodd proposal.
 - **Compliance Reporting.** Companies that are subject to this requirement and are not bank or thrift holding companies may be required to submit reports under oath concerning their ability to serve as a source of strength and to comply with the source of strength requirement.

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

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

Regulation of Banks

- **No Conversions When Formal or Informal Supervisory Action is Pending.** Conversion of national banking associations into a state bank or thrift, and vice versa, prohibited during any period in which the converting entity is subject to a cease and desist order, a memorandum of understanding, or any other enforcement action issued or entered into with respect to a significant supervisory matter.

- A similar provision applies to the conversion of a Federal thrift to a national or state bank or thrift.
- Similar to November Dodd proposal and House bill.
- **Broadened Lending Limits for Insured State Banks.** National bank lending limits also apply to insured state banks.
- **De Novo Interstate Branching.** Permits de novo interstate branching by national banks and insured state banks by amending the state “opt-in” election. Although not precisely the same interstate branching rule as thrifts now enjoy, due to technical requirements in the HOLA, it would place banks and thrifts generally on equal footing.
 - Applications for out-of-state de novo branches would be approved if, under the law of the state in which the branch is to be located, a state bank chartered by such state would have been permitted to establish the branch.

Transactions with Affiliates and Insiders

- **Expansion of 23A to Derivatives and Securities Borrowing/Lending.** Treats credit exposure on derivatives transactions and securities borrowing and lending transactions with affiliates as covered transactions for purposes of Section 23A of the Federal Reserve Act. Requires collateral for all covered transactions to be maintained at all times. Treats financial subsidiaries prospectively as affiliates for purposes of Section 23A. Limits the applicable bank regulator’s authority to grant exemptions under Sections 23A and 23B.
 - **Netting.** Allows Fed to determine how netting agreements may be taken into account in determining the amount of a covered transaction with an affiliate.
- **Transactions with Insiders.** Strengthens insider loan restrictions (including credit exposures on derivative transactions with insiders) and imposes limitations on asset purchases from insiders. Fed must consult with OCC and FDIC before proposing or adopting rules under the asset purchase provision.

Lending Limits

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

FDIC Deposit Insurance Assessments Based on Assets

- Requires the FDIC to base deposit insurance assessments on an insured depository institution’s total consolidated assets minus the sum of its equity plus its long-term unsecured debt, rather than on its deposit assessment base, unless the FDIC makes a written determination that such a change would reduce effectiveness of FDIC’s risk-based assessment system or increase risk of loss to the Deposit Insurance Fund.
- Repeals provision that no institution may be denied the lowest-risk category solely because of its size.

Securities Holding Companies

- **New Regime in Lieu of Elective Investment Bank Holding Company Status.** Replaces the ability of an investment bank holding company without a bank or thrift affiliate to elect supervision by the SEC with the securities holding company regime.
- **Purpose.** Permits a securities holding company that is required by a foreign regulator to be subject to comprehensive consolidated supervision to register with the Fed to become a “supervised securities holding company.”
- **Eligibility.** Available for “securities holding companies,” *i.e.* firms that own or control a SEC-registered broker-dealer, but are not systemically important nonbank financial companies, do not otherwise already have an appropriate federal banking agency engaging in comprehensive supervision, and are not already subject to comprehensive consolidated supervision by a foreign regulator.
- **Capital and Risk Management.** Prescribes capital adequacy and other risk management standards for supervised securities holding companies, taking into account differences among types of business activities and other enumerated factors. Permits Fed to differentiate among supervised securities holding companies on an individual basis or by category.
- **Examinations and Recordkeeping.** Permits Fed to examine a supervised securities holding company and any affiliate. Permits Fed to impose recordkeeping requirements.
- **Bank Holding Company Act and Federal Deposit Insurance Act.** Generally subjects supervised securities holding companies to the provisions of the BHC Act other than the restrictions on nonbanking activities and investments in Section 4 of the BHC Act., but including the requirement in Section 3 of the BHC Act to obtain prior Fed approval for acquisitions of more than 5 percent of any class of voting shares of a bank or bank holding company. Applies certain provisions of Section 8 of the FDIA to supervised securities holding companies and most nonbank subsidiaries as if the Fed were such entities’ appropriate federal banking agency.

IV. Resolution (Orderly Liquidation) Authority

Orderly Liquidation Authority

- **Still Modeled on Bank Resolution Statute.** Despite the new label and certain important changes outlined below, Senator Dodd’s proposed orderly liquidation authority continues to be modeled largely on the resolution authority for insured depository institutions in the Federal Deposit Insurance Act.
 - **Core Resolution (Orderly Liquidation) Powers Retained.** In particular, the FDIC would retain its core resolution powers to take control of the institution as receiver, to act quickly to sell all or any selected assets and liabilities to a third party (regardless of priorities among creditors and without the consent of any affected party or court approval – *i.e.*, “cherry pick”) or, if a third party buyer cannot be found at fair value, to establish one or more temporary bridge financial companies to hold the part of the business worth preserving until it can be sold to one or more third parties at fair value or liquidated in an orderly fashion.
- **New Proposal Contains Four Significant Changes:**
 - **Gatekeeping Role for Special Bankruptcy Panel.** As an additional condition to appointing the FDIC as receiver of a financial company under the new proposal, requires the Treasury Secretary to persuade a special panel of bankruptcy judges that there is a “substantial basis” for concluding that the financial company is in “default or in danger of default” (as defined).

- **Composition of Panel.** Special panel composed of 3 bankruptcy judges from the Bankruptcy Court of the District of Delaware.
- **Confidential.** Proceeding would be confidential, backed up by criminal penalties for “reckless” (but not merely negligent) disclosures.
- **Expedited.** Special panel would be required to rule within 24 hours of the filing of a petition by the Treasury Secretary.
- **Due process.** Affected company would be given notice of the hearing and an opportunity to oppose the determination.
- **No Authority to Second Guess Systemic Risk Determinations.** Panel’s authority would be limited to reviewing “substantial evidence” for Treasury’s financial distress determination, and would not extend to the Treasury Secretary’s systemic risk determinations.
- **Company Consent.** Definition of “default or in danger of default” expanded to include consent by a company’s board or shareholders for the FDIC’s appointment as receiver under the orderly liquidation authority. Thus, not purely an “insolvency” determination.
- **Appellate Review; No Stay.** Either party may appeal decision to the U.S. Court of Appeals for the Third Circuit on expedited basis, but decision may not be stayed or enjoined pending appeal.
- **Reducing Gap with Bankruptcy Code.** Reducing the gap between the rules defining creditors’ rights under the Bankruptcy Code and the new orderly liquidation authority, although it would not close the gap altogether. Changes include:
 - **Preferential or Fraudulent Transfers.** Legally enforceable or perfected security interests and other transfers of property would no longer be avoidable if “taken in contemplation of the company’s insolvency” as under the bank resolution provisions in the Federal Deposit Insurance Act. Instead, they would be avoidable only if they amounted to preferential or fraudulent transfers under the Bankruptcy Code.
 - **Special Enforceability Requirements.** Although agreements against the interest of the receiver or a bridge financial company would still have to be in writing and meet certain other special enforceability requirements to be enforceable against them as required by the bank resolution statute (but not the Bankruptcy Code), any written agreement that was duly executed or confirmed in the ordinary course of business that the counterparty could prove to the satisfaction of the receiver would be enforceable (closer to Bankruptcy Code).
 - **Contingent Claims.** Contingent claims in the form of guarantees, letters of credit, lines of credit and other similar claims would be recognized as provable claims equal to their estimated value as of the date of the receiver’s appointment, which would be estimated in a manner similar to how they are estimated under the Bankruptcy Code.
 - **Security Interest and Security Entitlements.** Legally enforceable or perfected security interests and legally enforceable security entitlements in respect of assets held by the covered financial company would be respected as property rights.
 - **Damages for a Repudiated Debt Obligation.** Would be calculated as the face amount of the obligation plus accrued interest and accreted original issue discount, determined as of the date of the receiver’s appointment.
 - **Limited Right to “Post-Appointment” Interest.** Similar to “post-petition” interest provisions of the Bankruptcy Code, for secured claim, any accrued interest would be calculated through the date of repudiation, to the extent that such allowed secured claim is secured by property the value of which is greater than the amount of such claim.

- **Setoff Rights.** Setoff rights respected as under the Bankruptcy Code, with some qualifications to permit receiver to transfer liabilities to third party or bridge financial company even if it destroys the mutuality of offsetting claims.
- **Choice of Law Rules.** Noninsolvency choice of law rules would determine applicable noninsolvency law governing the perfection of security interests and the creation and enforcement of security entitlements.
- **Additional Due Process.** Narrows the gap between the due process protections of the Bankruptcy Code and those provided under the bank resolution statute on which this orderly liquidation authority is modeled, including gatekeeping role of the special bankruptcy panel, additional opportunity for judicial review of the claims process and certain notice and hearing rights.
- **Minimum Recovery Right.** To ensure minimum due process, all creditors would be entitled to receive at least what they would have received in a liquidation of the covered financial company under Chapter 7 of the Bankruptcy Code, even if some creditors receive more than they would have received in a Chapter 7 liquidation because the receiver transferred their claims to a third party or bridge financial company and chose not to recoup any excess benefits from the transferred creditors for the benefit of the left-behind estate.
- **Mandatory Rulemaking.** The FDIC would be required to promulgate rules to implement the orderly liquidation authority in a manner that increases legal certainty and further reduces the gap between how creditors are treated in a liquidation under the Bankruptcy Code and how they are treated under the orderly liquidation authority.
- **Covering Broker-Dealers and Protecting Customer Property.** Clarifying that the new resolution authority would apply to *broker-dealers that are members of SIPC* and attempting to create a framework for providing the same protection for customer property as would be provided in a normal SIPC proceeding under SIPA. ***Although it is far from clear that the proposed new customer protection rules work as a technical matter,*** the following summarizes how we believe the new proposal was intended to work:
 - The FDIC would appoint SIPC to act as trustee for liquidation of the broker-dealer.
 - Liquidation of the broker-dealer would follow normal SIPC processes, with the same customer protection priorities.
 - However, qualified financial contracts would be governed by special provisions that supersede SIPC practices.
 - Concurrent with the FDIC-appointed SIPC liquidation, the FDIC could create a “bridge financial company” and transfer customer accounts, assets and liabilities to the bridge company from the broker-dealer.
 - Despite this transfer, SIPC would be required to satisfy remaining customer claims “in the same manner and amount” as if the FDIC was not involved in the liquidation.
 - The bridge financial company would be deemed registered with the SEC and SROs and could operate as a broker-dealer subject to compliance with the securities laws. It is not clear how the broker-dealer capital rules and mechanics of operation such as clearing arrangements would apply to the bridge broker-dealer.
- **Upfront Orderly Liquidation Fund.** Like the House Bill, creating an orderly liquidation fund that would be funded in advance.
 - **Target Size.** \$50 billion, instead of \$150 billion as in the House Bill.

- **Funding.** The fund would be capitalized by the FDIC making “graduated assessments” on “eligible financial companies” during an “initial capitalization period,” and any losses in the fund would be made up by “additional assessments” on eligible financial companies and other financial companies with total assets for more than \$50 billion.
- **Eligible Financial Companies.** Any bank holding company with total assets of over \$50 billion and any nonbank financial company designated as systemically important by the Council.
- **Initial Capitalization Period.** A 5-10 year period beginning one year after the date of enactment, subject to extension with the approval of the Secretary.
- **Graduated Assessments Based on Assets, Risks and Other Factors.** The FDIC is required to impose higher rates based on risk and size of assets (i.e., the higher the risk and higher the assets, the higher the assessment rates). The FDIC must take the following factors into account in determining the size of assessments:
 - **General Conditions.** Economic conditions generally at the time;
 - **Other Guarantee Arrangements.** Any assessments imposed pursuant to other laws on an eligible financial company’s insured depository institution subsidiaries to fund deposit insurance, on broker-dealer subsidiaries to fund SIPC insurance or on the eligible financial company (if an insurance company) or an insurance company subsidiary for a state insurance guarantee fund;
 - **Financial Condition.** Financial condition of the company;
 - **Risk to the System.** Risk presented by the financial company to U.S. financial stability;
 - **Beneficiary of Orderly Liquidation.** The extent to which the company received benefitted, or likely would benefit, from the orderly liquidation of a covered financial company (compared, for example, to a liquidation under Chapter 7 of the Bankruptcy Code); and
 - **Other Factors.** Other factors that the FDIC deems appropriate.
- **Suspension of Assessments.** The FDIC is prohibited from making additional assessments once the fund reaches its target size, unless necessary to replenish the fund if it drops below its target.
- **Additional Assessments.** Permitted if the fund falls below the target size after the initial capitalization period, the FDIC incurs a loss as receiver of a covered financial company during the initial capitalization period, or the FDIC determines that additional assessments are necessary to repay obligations issued to the Treasury Secretary.
 - **Higher Rate for Companies That Received Excess Benefits.** The FDIC is required to impose additional assessments at a higher rate on any financial company that received any excess benefits as creditor in the receivership of another covered financial company.
- **Rulemaking.** The FDIC would be required to issue rules and regulations to govern the assessment process and use of the Orderly Resolution Fund.
- **Acceptable Orderly Liquidation Plan.** The FDIC may not use any of the amounts in the Orderly Liquidation Fund as receiver for any covered financial company unless and until it shall have submitted an orderly liquidation plan for such company that is acceptable to the Treasury Secretary.

- **Borrowing Authority.** The FDIC would be authorized to borrow from the Treasury by issuing debt securities to it, subject to the following conditions:
 - **Fund Already Drawn Down.** Cash and cash equivalents held by the Fund must have previously been drawn down to facilitate the orderly liquidation of a covered financial company; *and*
 - **Borrowing Limits.** The FDIC may not incur any debt obligation to the Treasury if the aggregate of such obligations would at any time exceed the sum of:
 - the amount of cash or cash equivalents, if any, left in the Fund; and
 - 90% of the fair value of the assets of from each covered financial company that are available to repay the FDIC.
- **Other Important Changes:**
 - **QFCs.** Automatic stay extended to five business days (compared to one in the House Bill).
 - **Guaranteed Subsidiary Contracts.** FDIC would have the power to enforce subsidiary contracts that are guaranteed by a covered financial company in receivership notwithstanding any cross-default in the underlying contract based solely on the insolvency of the guarantor, if the guarantee and all related assets/liabilities are transferred to a bridge financial company or a third party.
 - **Clearing Organization.** The receiver would be required to use its best efforts to meet all margin, collateral and settlement obligations of a covered financial company with a clearing organization; if the receiver defaults on such obligations, the clearing organization would have the right to exercise its rights and remedies immediately despite any otherwise applicable stay on the exercise of close-out or other rights.
 - **No Haircuts on Secured Credit.** No Miller-Moore language regarding haircuts on secured creditors.

V. Emergency Financial Stabilization Powers

Modifications to 13(3) Emergency Secured Liquidity Powers

- **Limits Power to Market Utilities and Market-Wide Programs.** Limits Section 13(3) assistance to a “financial market utility” that the Council determines is or is likely to become systemically important and to a “program or facility with broad-based eligibility,” but not to any single individual, partnership or corporation.
- **Policies and Procedures.** Fed must establish by regulation, in consultation with the Treasury Secretary, policies and procedures governing emergency lending designed to ensure that any emergency lending program or facility is designed to provide liquidity to the financial system and not to aid a failing financial company; and that collateral for emergency loans is of sufficient quality to protect taxpayers from losses.
- **Political Approval and Reporting Requirements.** Fed must receive approval of Treasury Secretary prior to establishing such a program or facility and must provide to Congress, within 7 days, a report that justifies the exercise of authority and describes the material terms of the assistance. The GAO is given authority to audit any Section 13(3) facility or existing Federal Reserve credit facility.

Emergency Financial Stabilization

- **Liability Guarantee Programs.** Provides that the FDIC can create a widely available program to guarantee obligations of solvent depository institutions, depository institution holding companies and

affiliates during times of severe economic distress. This authority would replace Section 13(c)(4)(G)(i) of the FDIA as the source of authority for widely available guarantee programs.

- **Policies and Procedures.** FDIC must establish by regulation, with the concurrence of the Treasury Secretary, policies and procedures governing issuance of such guarantees. Triggering of guarantee program requires finding by 2/3 of the Council and Fed that there has been a liquidity event and that a failure to take action would have serious adverse effects on financial stability or economic conditions in the U.S.
- **No Equity Investments.** The guarantee may not include the provision of equity in any form.
- **Borrowing Power and Costs.** FDIC can borrow from the Treasury but must charge fees and other assessments to participants in such amounts as are necessary to offset projected losses and administrative expenses.
- **Congressional Veto.** Congress is authorized to veto an increase of the amount of debt that can be guaranteed through a joint resolution within a 5 calendar day period.

VI. Federal Reserve Governance

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

VII. Bureau of Consumer Financial Protection

- **Scope of Authority.** As in the House bill, Consumer Bureau would have very broad powers to regulate and enforce substantive standards for any person engaged in offering or selling a "consumer financial product or service."
- **Not a Stand-Alone Agency.** Consumer Bureau established within the Federal Reserve System, but the Director is appointed by the President, by and with the advice and consent of the Senate. Fed is forbidden from intervening in Consumer Bureau examinations or enforcement actions or delaying or preventing the issuance of any Consumer Bureau rule or order.
- **Checks on Consumer Bureau's Rulemaking Authority.**
 - **Council Stay and Veto Power.** Chairman of the Council may temporarily stay the effectiveness of a Consumer Bureau regulation if petitioned to do so by a member agency, and upon a 2/3 vote of its members the Council may permanently set aside a Consumer Bureau regulation.

- **Written Objection of Prudential Regulator.** If a prudential regulator objects in writing to a proposed Consumer Bureau rule, the Consumer Bureau must include the objection in the rule's adopting release and explain the Consumer Bureau's decision regarding the objection.
- **Enforcement Authority over "Very Large" Insured Depository Institutions.** Consumer Bureau has primary enforcement authority with respect to any insured depository institution with total assets of \$10 billion or more **and any affiliate thereof** (except those affiliates explicitly carved out of the Consumer Bureau's authority, such as broker-dealers and insurance companies). Smaller insured depository institutions will be subject to the exclusive enforcement authority of their prudential regulators.
- **Enforcement Authority over Nondepository Covered Persons.** Consumer Bureau has primary enforcement authority with respect to nondepository covered persons to the extent that they (i) offer, provide or service consumer real estate loans, or provide loan modification or foreclosure relief services in connection with such loans; or (ii) are "larger participants" of a market for other consumer financial products or services as defined by rule by the Consumer Bureau in consultation with the FTC.
- **Extent of Regulated Entity Carve-Out from Authority of Consumer Bureau of Consumer Financial Protection Remains Unclear.** It is unclear whether language in the March Dodd proposal is intended to change the degree to which certain regulated entities are carved out from the authority of the Consumer Bureau in the House bill. In particular:
 - The scope of the prohibition on the ability of the Consumer Bureau to act with respect to such regulated entities differs:
 - House bill provides, *e.g.*, that the CFPB/Consumer Bureau shall have "no rulemaking supervisory, enforcement or other authority" with respect to a person regulated by the SEC
 - Senate bill provides, *e.g.*, that the Consumer Bureau shall have "no authority to enforce this title" with respect to such persons.
 - The scope of such regulated entities' activities carved out from the authority of the Consumer Bureau differs:
 - House bill carves out, *e.g.*, any person "regulated by" the CFTC, but only to the extent that such person "acts in a registered capacity";
 - Senate bill carves out, *e.g.*, any person "regulated by" the CFTC, but only to the extent that such person's activities are "subject to the jurisdiction of the [CFTC] under the Commodity Exchange Act."
- **Relationship to State Law**
 - OCC authorized to preempt state law "in accordance with the legal standard of the Supreme Court in *Barnett Bank v. Nelson*," which holds that states may regulate national banks where "doing so does not prevent or significantly interfere with" a national bank's exercise of its powers.
 - Preemption authority not granted with respect to subsidiaries or affiliates of national banks that are not national banks themselves.
 - Evidentiary burden and deference standards imported from House bill.
 - State attorneys-general retain enforcement power; can bring a civil action to enforce this title and other laws; other state agencies free to bring a civil action to enforce this title and other laws with respect to any entity that is state-chartered, incorporated, licensed or otherwise authorized to do business in the state.

- **Funding.** Consumer Bureau would not be funded by assessments on covered companies, but would receive annually from the Fed an amount equal to 10% of the Fed's total operating expenses.
- **Other Notable Provisions**
 - **Community Reinvestment Act No Longer an “Enumerated Consumer Law.”** Presumably will remain within the authority of the appropriate Federal banking agencies.
 - **Addition to the Definition of “Financial Product or Service”.** Any financial product or service permissible for a bank or for a financial holding company to offer or provide under federal law or regulation that has, or likely will have, a “material impact on consumers,” as determined by the Consumer Bureau.
 - **New Carve-outs from Definition of “Financial Product or Service”:**
 - Extension of commercial credit to a person who originates consumer credit transactions.
 - Sale of a stored value product if the seller does not exercise “substantial control” over the terms or conditions of the stored value product, *i.e.*, the seller simply sells the product but does not establish its terms and conditions.
 - Publishing market data, news, or data analytics or investment information or recommendations that are not tailored to the individual needs of a particular consumer.
 - Collecting, analyzing, maintaining or providing consumer report information, including credit histories of consumers, that relates solely to purchase finance transactions between a consumer and such person.
 - **Authority to Restrict Mandatory Predispute Arbitration.** Consumer Bureau must conduct a study of mandatory predispute arbitration provisions before it may determine to limit their use; any such limits must be consistent with the findings of the study.
 - **Disclosure Rules.** Consumer Bureau authorized to prescribe disclosure rules with respect to the features of consumer financial products or services; Consumer Bureau may issue model disclosure form, use of which establishes a disclosure compliance safe harbor.
 - **Prohibition on Certain Prepayment Penalties.** Prohibits prepayment penalties on residential mortgage loans that are not “qualified mortgages,” *i.e.*, non-traditional mortgages that do not meet certain criteria, including that they be fully documented, fixed-rate and fully amortizing; also limits but does not outright prohibit prepayment penalties with respect to qualified mortgages, requiring lenders offering products containing such penalties to offer products without them.

VIII. Derivatives

- **Derivatives Warning.** The current derivatives title is understood to be a placeholder for a later title. Senators Jack Reed and Judd Gregg are working on a substitute amendment to the derivatives title that may be offered at full committee.
- **Major Swap Participant Definition.** Defines major swap/security-based swap participant (“MSP”) as any non-dealer who maintains a substantial net position in outstanding swaps or security-based swaps (“swaps”), excluding positions held for hedging commercial risk, or whose failure to perform under the terms of its swaps could cause significant credit losses to swap counterparties.
 - Requires the CFTC and the SEC to implement the definitions of major swap/security-based swap participant by rule or regulation in a manner that is “prudent for the effective monitoring, management and oversight of the financial system.”

- House bill is narrower and would exclude a non-dealer with a non-substantial net position or with a substantial position in swaps used for hedging unless such participant's swaps create substantial net counterparty exposure that poses a systemic risk to the U.S. markets.
- **Clearing Requirements**
 - Imposes a central clearing requirement on certain swaps that clearinghouses will accept for clearing and that the CFTC/SEC requires to be cleared.
 - Requires CFTC/SEC approval for a swap to be cleared.
 - Permits the CFTC and SEC to grant exemptions for a swap with an end-user (non-MSP) where the end user does not meet the eligibility requirements of a clearinghouse. An exempt swap must be cleared upon the request of either counterparty.
 - Requires nondiscriminatory clearing of swaps executed on or through the rules of an unaffiliated national securities exchange/designated contract market or an alternative swap execution facility.
 - Requires that all non-cleared swaps be submitted to a swap repository or the CFTC/SEC, which must make public aggregate data on all cleared and non-cleared swaps. Same for swaps entered into prior to the application of the clearing requirement.
 - Requires large swap traders to keep books and records of any cash or spot transactions in, inventories of, and purchase and sale commitments of, any related commodity traded on or subject to the rules of any board of trade.
- **Trade Execution Requirements**
 - Requires that all swaps that are subject to the clearing requirement be exchange-traded or traded on an "alternative swap execution facility."
 - Defines alternative swap execution facility as an electronic trading system that has pre-trade and post-trade transparency in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by other participants that are open to multiple participants in the system, but which is not an exchange.
 - House bill defines swap execution facility as any person or entity that facilitates the execution or trading of swaps, including any electronic trade execution or voice brokerage facility.
 - Requires alternative swap execution facilities to make public timely information on trading data.
 - Requires that all contracts with "non-eligible contract participants" (such as municipalities and individuals who do not meet certain asset size thresholds) to be exchange-traded.
- **Capital and Margin Requirements**
 - Imposes capital and margin requirements for swap dealers and MSPs, with capital requirements required to be higher for non-cleared swaps.
 - Authorizes the CFTC/SEC, in consultation with the Financial Stability Oversight Council, to exempt nonbank swap dealers and MSPs from capital and margin requirements for swaps with an end user counterparty who is using the swap as part of an effective hedge under generally accepted accounting principles and is predominantly engaged in activities that are not financial in nature.
 - Gives regulators discretion to allow for use of non-cash collateral to meet margin requirements.

- **Segregation of Collateral**
 - At the request of a counterparty, requires a dealer to segregate and hold in an account carried by an independent third-party custodian the initial margin or collateral for OTC swap transactions.
 - Limits the investment of segregated funds or other property to such investments as the CFTC/SEC/primary bank regulatory authority permits by rule or regulation and prohibits the pledge, rehypothecation or encumbrance of such property by a dealer.
 - Requires dealers and clearinghouses to segregate collateral held for cleared swaps.
- **Position Limits**
 - Authorizes the CFTC to set aggregate position limits for commodity contracts listed on a designated contract market, commodity contracts traded on certain foreign boards of trade and swaps that perform or affect a significant price discovery function with respect to regulated markets.
 - Authorizes the SEC to establish aggregate position limits across security-based swaps that perform or affect a significant price discovery function with respect to regulated markets and direct self-regulatory organizations to adopt rules for position limits in any security-based swap and any security on which such security-based swap is based.
- **Regulation of Swaps**
 - Grants the CFTC and the SEC joint jurisdiction over “mixed swaps” that contain both swap and security-based swap components.
 - Excludes foreign exchange forwards and swaps from regulation.
- **Extraterritoriality**
 - March Dodd proposal and the House bill grant the SEC/CFTC authority to exempt a swap repository, derivatives clearing organization or (alternative) swap execution facility if the SEC/CFTC finds that the entity is subject to comparable regulation by its home country.
 - House bill excludes from regulation only those activities outside the United States that do not have a direct and significant connection with activities in the United States or have an effect on U.S. commerce or contravene rules and regulations that the CFTC/SEC prescribes to prevent evasion of regulation.
 - March Dodd proposal does not address territorial limits.
- **Lynch Amendment – Conflicts of Interest**
 - House bill requires clearinghouses, boards of trades, exchanges and swap execution facilities to have rules prohibiting “identified financial companies” that are swap dealers or major swap participants or persons associated with them from:
 - Being associated with a majority of the directors of such an entity, and
 - Acquiring, directly or indirectly, beneficial ownership of interests in any such entity to the extent it would allow these identified financial companies, in the aggregate, to vote or cause to be voted or withhold more than 20% of the votes entitled to be cast.
 - Dodd March proposal does not contain these limitations.
 - House bill authorizes the CFTC and the SEC to adopt rules mitigating conflicts of interest in connection with a swap dealer or MSP’s conduct of business with a clearinghouse, board of trade/exchange or alternative swap execution facility that clears or trades swaps in which such person has a material debt or equity investment.

- Dodd March proposal requires the CFTC and the SEC to jointly adopt such rules.

IX. Credit Retention Requirements

- **Key regulators.** Regulation of ABS by the OCC, FDIC and SEC.
- **Credit Retention Requirements.** Federal banking agencies and SEC to jointly prescribe standards that require securitizers of ABS, by default, to maintain 5% of the credit risk in assets transferred, sold or conveyed through the issuance of an ABS by the securitizer; regulators have flexibility to impose lower-than-5% risk retention if underwriting/diligence meets certain prescribed underwriting standards specific to the class of the securitized asset.
- **No Hedging of Retained Credit Risk.** Prohibits the covered party from hedging the required retained credit risk.
- **Sharing of Risk Retention by Securitizer and Originator.** Amount of risk retention required of a securitizer to be reduced by the amount of risk retention required of the originator.
- **Exemptive Authority.** Federal banking agencies and SEC can jointly adopt or issue exemptions, exceptions or adjustments to the risk retention rules.
- **Asset Classes.** Regulators to establish different asset classes with different credit retention rules, including ABS backed by residential mortgages, commercial mortgages, commercial loans, auto loans, and any other class of assets deemed appropriate.
- **Timeframe.** Effective one year after publication of the final rules in the Federal Register for residential mortgage-backed securities, 2 years for all other classes of securities.
- **Syndicated Loans.** Scope unclear – conventional syndicated loans not exempted.
- **Heightened Reporting and Disclosure.** Requires heightened reporting and disclosure related to ABS.
- **Disclosure of Repurchase Request.** Requires that securitizers disclose both fulfilled and unfulfilled repurchase requests across all trusts aggregated by the securitizer.

X. Payment, Clearance and Settlement

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

XI. Changes in Broker-Dealer Regulation and Investor Protection

Broker-Dealer Regulation

- **Fiduciary Duty Study.** Requires an SEC study of the effectiveness of existing standards of care for broker-dealers and investment advisers for providing personalized investment advice and recommendations about securities to retail customers. The topics to be addressed are expressly prescribed in the bill. The SEC is required to seek and consider public input, comments and data. If the study concludes that gaps or overlaps exist, SEC required to promulgate rules under its existing statutory authority within 2 years of the enactment of the bill.
 - House bill requires the SEC to impose a fiduciary duty on broker-dealers providing investment advice about securities to retail customers.
 - November Dodd proposal requires that most broker-dealers register as investment advisers.
- **Short Sales.** No provision to require institutional investment managers to provide the SEC with daily reports regarding short sales, as was included in the House bill.
- **Securities Lending.** Requires the SEC, within 1 year after the enactment of the bill, to promulgate rules designed to increase the transparency of information available regarding securities lending. No similar mandate is included in the House bill or the November Dodd proposal.
- **Portfolio Margining.** Encourages portfolio margining by providing SIPC protection to futures and options on futures in portfolio margining accounts; does not resolve futures segregation obstacles.
- **SRO Filing Procedures**
 - SRO rules would become effective if the SEC fails to approve or disapprove the rule filing within specified times. The date of publication of a rule filing, which triggers the time periods, would begin with publication of a submitted rule filing on the SRO's website.
 - The category of rule filings that are "effective on filing" would be expanded to include fees charged to non-members, such as market data fees.
- **Point of Sale Disclosures.** Provides the SEC with express authority to issue rules designating disclosure that must be provided by a broker-dealer to a retail investor before the purchase of an investment product or service by the retail investor.
- **Investor Advisory Committee / Investor Advocate / Investor Testing**
 - Establishes an Investor Advisory Committee with membership that represents, among others, individual investors and state securities commissions. SEC is required to issue a public statement assessing any findings or recommendations of the committee.
 - Establishes an Office of Investor Advocate, appointed by, and reporting directly to, the Chairman, that is charged with assisting retail investors.
 - Provides the SEC with express authority to engage in investor testing programs.
- **Studies Regarding Financial Literacy and Mutual Fund Advertising**
 - SEC is required to study the financial literacy of retail investors.
 - GAO is required to study mutual fund advertising.
- **Municipal Securities**
 - Municipal Securities Advisors and MSRB Authority

- Requires registration and oversight of municipal advisors that provide advice to, or undertake solicitation of, issuers of municipal securities with respect to the issuance of municipal securities, investment of proceeds of municipal offerings or derivatives on municipal securities.
- Expands the rulemaking authority of the Municipal Securities Rulemaking Board (“MSRB”) over broker-dealers, municipal securities dealers and municipal advisors with respect to the issuance of municipal securities, investment of proceeds of municipal offerings or derivatives on municipal securities. Otherwise provides the MSRB with rulemaking authority regarding municipal advisors comparable to its authority regarding municipal securities dealers. Extends MSRB rulemaking authority over sales by a broker-dealer of any part of a new issue of municipal securities to a related account during the underwriting period and solicitation of municipal entities.
- Expands the MSRB’s authority to regulate advice provided to or on behalf of “obligated persons,” which includes any person who is committed to support the payment of all or part of the obligations on municipal securities.
- Requires the MSRB to adopt rules that require continuing education requirements for municipal advisors and professional standards.
- Requires MSRB rules to not impose an inappropriate regulatory burden on small municipal advisors.
- Reconstitutes the MSRB with a majority of board members that are not affiliated with broker-dealers, municipal dealers or municipal advisors.
- Authorizes the MSRB to impose penalties for violations of its rules.
- Authorizes the MSRB to assist the SEC and FINRA in examinations and enforcement actions regarding MSRB rules, and retain half of any penalties imposed by the SEC in such enforcement actions.
- Authorizes the MSRB to establish information systems and impose fees for submission of information to these systems.
- Formalizes within the SEC an Office of Municipal Securities.
- **Municipal Security Studies**
 - Requires the GAO to study the value of enhanced municipal issuer disclosure, and the repeal of the Tower Amendment prohibition on the MSRB requiring issuer disclosure.
 - Requires the GAO to study the municipal securities markets, including an analysis of the mechanisms for trading, quality of trade executions, market transparency, trade reporting, price discovery, settlement, clearing, and credit enhancements, and how to improve transparency, fairness and liquidity.
 - Requires the SEC to study the funding mechanism for the Government Accounting Standards Board.

Capital Markets

- **Changes to SEC Regulation D Offerings**
 - Unlike the Dodd November bill, maintains federal preemption over Regulation D offerings. Permits SEC to deem certain classes of securities not to be “covered securities,” and thus subject to state regulation, based on an offering’s size or scope.

- In making this determination, the SEC is required to consider the size of the offering, the number of states in which the security is being offered, and the nature of persons to whom the security is being offered.
- **Expiring Status as Covered Security.** Requires the SEC to review all filings relating to securities exempt from registration under Section 4(2) of the Securities Act within 120 days; otherwise, such security will no longer be treated as a covered security.
 - Status as a covered security maintained if the State securities commissioner determines there has been a good faith and reasonable attempt by the issuer to comply with all applicable terms, conditions, and requirements, and any failure to comply is insignificant to the offering as a whole.
 - Requires SEC to implement procedures, in consultation with the States, to promptly notify states upon completion of review of such security offerings within 180 days of the passage of this Act.
- Maintains state notice filing requirements substantially similar to the filing requirements required by rule or regulation under section 4(2).
- **Clarification that Section 205 of the Investment Advisers Act Does not Apply to State Registered Advisers**
 - Revises Section 205 to clarify that any investment adviser not registered or required to be registered with the SEC is not subject to Section 205's restrictions on investment advisory contracts.
 - Deletes the condition that investment advisers must use mails or any means or instrumentality of interstate commerce in order to be subject to Section 205.

Securities Laws Enforcement

- **SEC Authority to Restrict Mandatory Pre-Dispute Arbitration.** Authorizes the SEC to conduct rulemaking reaffirming or prohibiting the use of mandatory arbitration pre-dispute agreements between broker-dealers and investment advisers.
 - The House bill provides the SEC with authority to conduct rulemaking that would only prohibit or limit arbitration.
 - The November Dodd proposal encourages rulemaking that would prohibit or limit arbitration.
- **SEC's Aiding and Abetting Authority.** The March Dodd proposal does not include provisions to expand the SEC's authority to pursue aiders and abettors of securities laws violators, or extend this authority under the Securities Act, Investment Company Act, and Advisers Act. These provisions were contained in the November Dodd proposal.
- **Whistleblower Protection.** Authorizes the SEC, in any action in which it levies sanctions in excess of \$1 million to compensate whistleblowers who provide original information with between 10% and 30% of the amount of the sanctions, an increase from the SEC's current authority under the Exchange Act, which caps such compensation at 10% of collected penalties, and restricts it to the insider trading context. Also establishes an Investor Protection Fund, intended to grow to a maximum of \$200 million through revenues from certain sanctions. Provides whistleblowers with an express private right of action against employers who retaliate against them.
 - Very similar to the House bill.

- **Extends whistleblower protection.** Subjects subsidiaries and affiliates that are consolidated with public companies for financial accounting purposes to the Sarbanes Oxley whistleblower provisions.
- **Collateral Bars.** Permits the SEC to impose collateral bars under the Exchange Act and the Advisers Act, prohibiting offenders from associating with a broad range of SEC regulated entities, rather than only those entities regulated under the particular statutory provisions under which the violation occurred.
 - Same as House bill.
- **No Private Civil Action for Aiding and Abetting.** The March Dodd proposal does *not* include a provision allowing for private civil actions against individuals who *knowingly or recklessly* aid or abet a violation of the Exchange Act, as did the November Dodd proposal. This provision would have overturned the *Stoneridge* decision.
- **Authority to Share Certain Information with Foreign Authorities.** Amends the Sarbanes-Oxley Act to provide for the sharing of information with foreign auditor oversight authorities without waiving confidentiality or privilege.
 - Unlike the House bill, requires the foreign authority give a description of the applicable information systems and controls that it has in place, as well as the laws and regulations of the foreign authority that are relevant to information access.

SEC Management

- **Report and Certification of Internal Supervisory Controls.** Requires the SEC to submit a yearly report to Congress that contains an assessment of the effectiveness of the internal supervisory controls of the SEC and the procedures that SEC staff use to perform examinations, investigations, and reviews of entities.
- **Triennial Report on Personnel Management.** Requires the GAO to submit a triennial report to Congress that evaluates the following areas in the SEC: the effectiveness of supervisors, promotion decisions, communication between different units of the SEC, turnover, whether there are excessive numbers of managers, initiatives to improve staff competency, and actions taken regarding employees who fail to perform their duties.
 - The report must also include recommendations on how the SEC can use human resources more effectively.
 - The SEC must submit a response 90 days after the GAO report is submitted detailing its response to the recommendations.
- **Annual Financial Controls Audit.** The SEC must submit a yearly report to Congress describing and assessing the SEC's establishment and maintenance of an adequate internal control structure and procedures for financial reporting.
 - Requires a similar report from the GAO.
- **Report on Oversight of National Securities Associations.** Requires the GAO to submit a report on the oversight by the SEC of national securities associations to Congress once every 3 years that evaluates: the governance of such associations; the examinations carried out by such associations; the executive compensation of such associations; arbitration services provided by such associations; the review performed by such associations on advertising by its members; the cooperation between such associations and state securities administrators to promote investor protection; the funding of such associations; the policies of such associations regarding employment of former employees of such associations by regulated entities; the effectiveness of the rules of such associations in

achieving the goals of the rules; the transparency or such associations; and the effectiveness of such associations along with both public and internal confidence in such associations.

- **Compliance Examiners.** Provides the Division of Trading and Markets and the Division of Investment Management of the SEC with a staff of examiners to perform compliance inspections and examinations of entities under the jurisdiction of those Divisions.
 - Effectively reorganizes the Office of Compliance Inspections and Examination.
- **Suggestion Program for Employees of the Commission.** The Inspector General of the SEC must establish a hotline for the receipt of suggestions by employees of the SEC for improvements and allegations by employees of waste, abuse, misconduct, or mismanagement.
 - Requires Inspector General to take appropriate action in response to such suggestions and allegations. Also requires a yearly report to Congress on such suggestions and allegations.
- **Provides for Self-Funding for the SEC.** Requires the Chairman of the SEC to submit a budget to Congress, but this is not considered a request for appropriations and the amount requested would automatically be given to the SEC.
 - The House bill provided the SEC with a set (though increased) budget.

PCAOB and Inspectors General

- **PCAOB Review of Auditors of Broker-Dealers.** Extends the authority of the Public Company Accounting Oversight Board (the “PCAOB”) to include auditors of registered broker-dealers. Permits PCAOB to refer investigations, as well as release documents and information gathered in investigations, to a registered broker-dealer’s SRO.
 - Effective 180 days after the Act.
 - Under current law, auditors of registered broker-dealers must be registered with the PCAOB. However, these auditors are not otherwise subject to the PCAOB oversight, which applies only to public companies.
 - Same as the House bill.
- **Changes in Appointments of Certain Inspectors General.** Requires presidential appointment and Senate approval for the Inspectors General of the Federal Reserve, the Commodity Futures Trading Commission, the National Credit Union Administration, the Pension Benefit Guaranty Corporation, the SEC, and the Consumer Bureau.
 - With the exception of the Consumer Bureau, requires the heads of each of these entities to address deficiencies identified by a report or investigation of the Inspector General of the entity.

XII. Corporate Governance

- **No Shareholder Vote on Staggered Terms of Directors.** Unlike November Dodd proposal, does not include a provision that limits companies from having boards with staggered terms without shareholder approval or ratification.
- **Proxy Access.** In a shift from the November Dodd proposal, the SEC “may”, but is not required, to issue rules permitting shareholders to use issuer proxy solicitation materials to nominate director candidates.
- **Majority Voting.** Listed companies must require that directors are elected in uncontested elections by a majority of the votes cast (the plurality standard applies if the election is contested). Directors

who receive less than a majority of the votes cast must tender their resignation and the board must accept the resignation within a period of time as disclosed or decline to accept the resignation and publicly provide the reasons, together with a discussion of the analysis used in reaching the conclusion, within 30 days.

- **Chairman and CEO Structure Disclosure.** Requires the SEC, within 180 days after enactment, to issue rules requiring companies to disclose in the proxy statement why the same or different persons serve as chairman and CEO.
- **Risk Committee Required** for systemically important, publicly traded nonbank financial companies that are supervised by the Fed, as well as publicly traded bank holding companies with total consolidated assets of \$10 billion or more. Risk committee must have the number of independent directors determined by the Fed (independence is not defined in this context), and include one risk management expert having experience in risk management at large complex companies.

XIII. Executive Compensation

- **No Say on Golden Parachutes.** Unlike the House bill and November Dodd proposal, does not provide for shareholder approval of golden parachutes.
- **Hedging Disclosure for Employees and Directors.** Requires companies to disclose whether employees and directors are allowed to hedge the value of any equity securities (not only equity compensation, as in the November Dodd proposal).
- **No Express Requirement for Independence of Compensation Committee Advisors.** Independence of consultants, legal counsel and other advisors to be engaged by compensation committees must be taken into account
 - Like the House bill and November Dodd proposal, provides that listed companies must have a compensation committee consisting of independent directors, and authorizes compensation committees to engage consultants, legal counsel and other advisors. Compensation committees are directly responsible for the appointment, compensation and oversight of the work of such advisors and are required to disclose whether a compensation consultant was retained.
- **Say on Pay.** Provides that at any annual meeting of shareholders, or special meeting in lieu thereof, held within 6 months after the bill's enactment, companies must provide their shareholders with an annual non-binding shareholder vote to approve the compensation of executives as disclosed pursuant to the SEC rules.
- **Pay and Performance Disclosure.** Requires companies to disclose the relationship between a company's executive compensation actually paid and financial performance, taking into account any change in the value of the company's shares, dividends and distributions.
- **Clawback.** The listing exchanges are directed to enforce the implementation of policies on incentive-based compensation that is based on publicly reported financial information and clawback policies enabling the recovery of incentive-based compensation from current or former executive officers following a restatement. The trigger would be based on material noncompliance with any financial reporting requirements that led to the restatement, during the three-year period preceding the date on which a company is required to prepare the restatement. The amount to be clawed back is the amount in excess of what would have been paid under the restated results.
- **Executive Compensation at Financial Institutions.** Amends the BHC Act so that it would be considered an unsafe and unsound practice for a holding company to provide an employee, director or principal shareholder with compensation that is excessive or could lead to material financial loss to the bank holding company.

- Unlike November Dodd proposal, does not expressly authorize regulators to impose higher capital charges if an institution has compensation practices that “pose risk of harm” or direct regulators to prohibit unsafe and unsound practices described under the bank holding company standard noted above.

XIV. Insurance

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

Office of National Insurance

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

State-Based Insurance Reform

- **Background.** The Nonadmitted and Reinsurance Reform Act, included in the Dodd March Proposal, is substantially identical to bipartisan legislation which was unanimously passed by the House on September 9, 2009 before being subsequently referred to the Senate Committee on Banking,

Housing, and Urban Affairs. Similar bills have passed in previous House sessions but have not been voted on by the Senate.

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

XV. Hedge Fund Registration

- **SEC Registration Required for a Broader Range of Advisers.** Like the November Dodd proposal and the House bill, the March Dodd proposal eliminates the “private investment adviser” exemption contained in Section 203(b)(3) of the Advisers Act.
- **“Private Fund” Definition.** The March Dodd proposal defines the term “private fund” to be any fund that would be an investment company but for the exemptions contained in Section 3(c)(1) or 3(c)(7) of the Investment Company Act. Definition the same as in the House bill, and does not include the

November Dodd proposal's additional requirement that such a fund either be created in the U.S. or have 10% or more of its securities owned by U.S. persons.

- **Significant Registration Exemptions.** Retains the November Dodd proposal's registration exemptions for advisers to venture capital funds and private equity funds. Both proposals require the SEC to promulgate rules defining the terms "venture capital fund" and "private equity fund."
 - House bill does not exempt advisors to private equity funds from registration.
- **Family Offices.** As in the November Dodd proposal, the March Dodd proposal exempts family offices from the definition of the term "investment adviser," placing such entities outside the purview of the Advisers Act. Unlike the November Dodd proposal, the March Dodd proposal requires that the SEC define the term "family office," for purposes of the exemption, in a manner consistent with its prior exemptive orders on the subject.
 - House bill does not contain a corresponding exemption.
- **Minimum Assets for SEC Adviser Registration.** \$100 million AUM SEC registration threshold for state-regulated investment advisers.
- **Records and Reports.** Provisions relating to records and reports broadly similar to the November Dodd proposal and the House bill.
 - Among other provisions, requires advisers to private funds to maintain (but not necessarily to file with the SEC) certain records and reports pertaining to the following items, which are subject to SEC inspection: amount of assets under management; use of leverage; counterparty exposure; trading and investment positions; valuation policies and practices; types of assets held; side arrangements or side letters; trading practices and other information deemed necessary by the SEC, in consultation with the Council.
- **Proprietary Information.** Provides enhanced protection with regard to the confidentiality of any proprietary information provided to the government (*i.e.*, not subject to FOIA and disclosure by SEC staff to those outside of the SEC generally requires pre-approval)
 - Not addressed in the November Dodd proposal.
 - Defines the term "proprietary information" to include: "(i) sensitive, non-public information regarding the investment or trading strategies of the investment adviser; (ii) analytical or research methodologies; (iii) trading data; (iv) computer hardware or software containing intellectual property; and (v) any additional information that the [SEC] determines to be proprietary."
 - House bill employs identical definition.
- **Disclosure of Client Identity.** Modifies current Advisers Act prohibition limiting the SEC's ability to require investment advisers to disclose the identity, investments or affairs of their clients by adding an exception enabling the SEC to require the disclosure of such information insofar as such disclosure is sought "for purposes of assessment of potential systemic risk."
- **Custody of Client Assets.** Allows for, but does not require, the SEC to promulgate rules to require registered investment advisers to take steps to safeguard client assets over which the adviser has custody. Suggests that such rules may, among other things, provide for verification of client assets by independent public accountants.
- **Accredited Investor Standard to be Adjusted for Inflation.** Requires the SEC to increase the financial thresholds applicable to an accredited investor who is a natural person in light of inflation and to adjust such thresholds at least once every five years.

XVI. Credit Rating Agencies

▪ **Credit Rating Agency Regulation Generally**

- March Dodd proposal generally increases internal controls, requires greater transparency of rating procedures and methodologies, provides investors with a private right of action, provides the SEC with greater enforcement tools, and provides for SEC examination of nationally recognized statistical rating organizations (“NRSROs”).
 - House Bill requires nearly all credit rating agencies to register as NRSROs and includes several unique provisions that do not appear in the March Dodd proposal.
 - November Dodd proposal included a Congressional finding that credit ratings on structured finance products ought not receive First Amendment protections.

▪ **Accountability for Ratings Procedures**

- **Internal Controls.** Each NRSRO must establish, maintain, enforce and document an internal control structure to govern implementation of and adherence to policies, procedures and methodologies for determining ratings.
 - SEC to require an annual internal controls report, including an attestation by the NRSRO’s CEO, to the SEC that describes management responsibility in establishing and maintaining internal control structure and assesses effectiveness of internal control structure.

▪ **Penalties for Certain Actions**

- **Penalties.** Broadens penalties that SEC may impose to include fines and expands misconduct to which such penalties apply to include failure to reasonably supervise an individual who commits a violation of the securities laws.
- **Suspension or Revocation of Registration.** Allows SEC to suspend or revoke registration of an NRSRO upon a determination, after notice and hearing, that the NRSRO lacks adequate financial or managerial resources to consistently produce accurate ratings.
 - SEC must consider, among other factors, whether NRSRO failed to produce ratings with integrity over a sustained period.

▪ **Management of Conflicts of Interest.** SEC must issue rules to prevent sales and marketing considerations from influencing production of ratings, with exemptions possible for small NRSROs, if separation of ratings production and sales and marketing would not be appropriate.

- If upon notice and hearing, SEC finds a violation that affected a rating, rules shall provide for suspension or revocation of the NRSRO’s registration.

▪ **Compliance**

- **Compliance Officer.** Designated compliance officer may not perform credit ratings or marketing or sales functions; participate in developing ratings methodologies or methods; or participate in establishing compensation levels (except for compliance personnel).
- **Compliance Report.** Requires annual report submitted to NRSRO by the designated compliance officer on compliance with securities laws and policies and procedures. Report must describe material changes to code of ethics and conflict of interest policies and a certification of accuracy and completeness.

- **Establishment of SEC Office of Credit Ratings**
 - **Staffing.** Office of Credit Ratings is to have a director (reporting to SEC Chairman) and sufficient staffing, including persons with expertise in specified debt products, to carry out Office's duties.
 - **Duties.** Must establish fines and other penalties for violations by NRSROs and administer SEC rules: with respect to NRSRO practices in determining ratings; to promote accuracy in ratings; and to ensure ratings are not unduly influenced by conflicts.
 - **Annual Examination.** SEC shall conduct an annual examination of each NRSRO, including a review of: whether the NRSRO adheres to its policies, procedures and rating methodologies; the management of conflicts of interest; the implementation of ethics policies; the internal supervisory controls; the governance of the NRSRO; the activities of the designated compliance officer; the processing of complaints; and policies governing post-employment activities of former staff.
- **Procedures and Methodologies**
 - **Procedures and Methodologies Rules.** SEC must issue rules with respect to procedures and methodologies (including qualitative and quantitative data and models) used by NRSROs.
 - The rules must require each NRSRO to:
 - Ensure ratings are determined in accordance with procedures and methodologies approved by NRSRO's Board of Directors or the senior credit officer and in accordance with policies and procedures for development of such procedures and methodologies.
 - Ensure that when material changes to rating procedures and methodologies occur, they are applied consistently to all ratings to which they apply, including current ratings (to the extent surveillance procedures and methodologies are impacted), and the reason for the change is publicly disclosed.
 - Notify ratings users of: the version of a procedure or methodology used with respect to ratings; when a material change is made to a procedure or methodology and the likelihood of this resulting in a change to current ratings; when a significant error is identified in a procedure or methodology that may result in credit rating actions.
 - **Outside Information.** In producing a rating, an NRSRO must consider information about an issuer that it has or receives (other than from issuer), if it finds the information credible and potentially significant to the rating decision.
 - **Qualifications for Ratings Analysts.** SEC must issue rules to ensure persons employed to perform ratings are tested for knowledge of the rating process and meet standards of training, experience and competence necessary to produce accurate ratings.
 - **Rules to Establish Substantive Contours of a Rating.** SEC must issue rules requiring each NRSRO to establish, maintain and enforce policies and procedures that assess the probability that an issuer will default, fail to make timely payments, or otherwise not make payments in accordance with the terms of an instrument.
 - November Dodd proposal did not include this provision.
 - **Ratings Symbols.** SEC rules must require each NRSRO to establish, maintain and enforce policies and procedures that clearly define and disclose the meaning of any ratings symbol and that apply this symbol consistently for all instruments for which the symbol is used. An NRSRO may still utilize distinct sets of symbols to denote credit ratings for different types of instruments.
 - November Dodd proposal did not include this provision.

- **Disclosure**
 - **Ratings Performance.** For purposes of allowing assessment of accuracy and establishing comparability across NRSROs, SEC must issue rules to require each NRSRO to publicly disclose information on initial ratings and any subsequent changes.
 - **Form to Accompany Ratings.** SEC must, by rule, require each NRSRO to accompany the publication of each rating with a prescribed form disclosing information about: assumptions underlying procedures and methodologies; data relied upon to determine the rating; if applicable, how servicer or remittance reports were used, and how frequently, to conduct surveillance; other items that might help users of ratings better understand ratings in each class.
- **Private Right of Action**
 - **Statements Made by Credit Rating Agencies.** Establishes that enforcement and penalty provisions of the Exchange Act apply to statements made by credit rating agencies in the same manner and to the same extent as they apply to statements made by registered public accounting firms or securities analysts under the securities laws. Clarifies that statements made by credit rating agencies are not forward looking statements for purposes of the Exchange Act's Section 21E safe-harbor.
 - November Dodd proposal limited the application of this provision only to NRSROs.
 - **State of Mind.** Modifies the requisite "state of mind" requirements for private securities fraud actions against a credit rating agency for money damages.
 - Sufficient to state with particularity facts giving rise to a strong inference that the credit rating agency knowingly or recklessly failed to conduct a reasonable investigation of a rated security with respect to factual elements relied upon by its own methodology or to obtain reasonable verification of such factual elements from sources independent of the issuer and underwriter that the credit rating agency considered competent.
 - House Bill applies a "gross negligence" state of mind with respect to violations of the securities laws. House Bill provides an additional private right for investors where the process of determining the rating was grossly negligent and a substantial factor in the investor's economic loss. House Bill also includes a provision that would nullify the effect of Rule 436(g) under the Securities Act.
 - November Dodd proposal limited the application of this provision only to NRSROs.
- **Obligation to Report Violations of Law**
 - **Duty to Report Violations.** Each NRSRO must refer to law enforcement or regulatory authorities any information received from a third party that the NRSRO finds credible and that alleges that an issuer of securities rated by the NRSRO committed or is committing a material violation of law.
- **Timing.** Unless otherwise specified, required rulemaking must be completed within 1 year of enactment.
- **Reliance on Credit Ratings in Statutes and Regulations**
 - **Study on Use of Ratings in Laws and Regulations.** Comptroller General must conduct a study of scope of Federal and State laws and regulations with respect to securities markets, banking, insurance, and other areas that require use of NRSRO ratings. Must evaluate the necessity for and purpose of such use; which uses could be removed with minimal market disruption; the

potential impact on markets and investors if such uses were rescinded; and whether rescission of such uses would benefit markets and investors.

- House Bill directly removes numerous Federal statutory references to credit ratings.
- **Agency Review and Modification of Ratings Requirements.** Specified Federal agencies must review their regulations and make modifications to remove any reference to credit ratings or a credit ratings requirement and to introduce, instead, the use of a standard of creditworthiness that is not related to credit ratings that the agency determines appropriate.
 - Exception is available if there is no reasonable alternative standard of creditworthiness and an amendment to the regulation would be inconsistent with the statute authorizing the regulation and not in the public interest.
 - November Dodd proposal did not contain this provision.
- **Studies and Reports**
 - **NRSRO Independence Study.** Requires SEC study of independence of NRSROs and how this affects ratings issued. Must evaluate, among other things, management of conflicts of interest by NRSROs providing non-rating services and potential impact of a prohibition on such services. Report to Senate Banking Committee and House Financial Services Committee on the results no later than 3 years after enactment.
 - House Bill bans NRSROs and associated persons providing non-rating service.
 - **Alternative Business Model Study.** Comptroller General must conduct a study of alternative means for compensating NRSROs to create incentives to provide more accurate ratings.
 - Report to Senate Banking Committee and House Financial Services Committee on the results no later than 1 year after enactment.
 - **Independent Professional Analyst Organization Study.** Comptroller General must conduct a study on feasibility and merits of creating an independent professional organization for NRSRO rating analysts that would establish independent standards and an ethics code and oversee the profession. Report to Senate Banking Committee and House Financial Services Committee on the results no later than 1 year after enactment.

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