FINANCIAL REFORM: 2010

The Final Dodd-Frank Wall Street Reform and Consumer Protection Act

A Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, As Signed by the President on July 21, 2010

REPORT ON FINANCIAL INSTITUTIONS

Gibson, Dunn & Crutcher LLP
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***Editor's Note*:**

This memorandum is organized topically, following the order of the Dodd-Frank Act's titles, but it does not necessarily follow the section-by-section order of the Act. As detailed in the table of contents, the order of major topics is as follows: financial stability, including the Financial Stability Oversight Council and stricter prudential standards for nonbank financial companies subject to Fed supervision and bank holding companies; resolution authority for large, interconnected financial companies; the OTS-OCC merger and regulation of savings associations; the regulation of advisers to hedge funds; insurance reforms, including the establishment of the Office of National Insurance; enhanced regulation of depository institution holding companies; regulation of over-the-counter derivatives markets; payment, clearing, and settlement supervision; investor protections and securities regulation reforms; the Bureau of Consumer Financial Protection and related preemption provisions; and amendments to the Fed's emergency lending authority and the FDIC's emergency financial stabilization program.

We continue to regard this memorandum as a work in progress. The memorandum aims to be a comprehensive summary of all important Dodd-Frank provisions; however, the length and complexity of the Act mean that there are a few sections that are not discussed. Further, although we have worked hard to make this memorandum an accurate discussion of this legislation, we may not have succeeded in every instance. ACCORDINGLY, WE WELCOME --INDEED INVITE -- YOUR COMMENTS AND CRITICISMS. Our website will allow you to access updated versions of this memorandum, and we encourage you to communicate your comments, corrections, and thoughts directly to us via e-mail at the addresses below. Or, of course, you may contact any of us the old-fashioned way: by telephone at the numbers listed below. We look forward to hearing from you.

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TITLE I: Financial Stability

A. Introduction

Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") seeks to increase financial marketplace transparency and stability by establishing a Financial Stability Oversight Council (the "Council") focused on identifying and monitoring systemic risks posed by financial firms and by financial activities and practices. It establishes a new regulatory and supervisory framework for "large, interconnected" banking organizations and certain nonbank financial companies. By a two-thirds vote, the Council can determine which U.S. and foreign nonbank financial companies that are predominantly engaged in financial activities (together "NBFCs") are to be subject to enhanced supervision ("Supervised NBFCs") by the Board of Governors of the Federal Reserve (the "Fed"), based on the perceived risk a company poses to financial stability in the United States. Empowering the Fed to implement this regime substantially enhances its powers and responsibilities.

The Act also contains an "anti-evasion" provision that allows the Council to designate for Fed supervision a company that is not an NBFC and thus cannot be designated a Supervised NBFC. If the Council determines such a company is "organized or operates in such a manner as to evade" the application of Title I, and engages in financial activities that meet the criteria for designation, those activities can be placed under Fed supervision under Title I. Title I provides for an intermediate holding company ("IHC") structure, subject to implementation by the Fed, so that the Fed can regulate such "evasion" activities and the financial activities of NBFCs, while leaving commercial and other nonfinancial activities outside this new regulatory regime.

Only bank holding companies ("BHCs")[1] with over $50 billion in consolidated assets are

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1 Note that Title I defines the term "bank holding company" to have the same meaning as in the Bank Holding Company Act of 1956 (the "BHC Act") and also specifies that a foreign bank or company that is treated as a BHC for purposes of the BHC Act pursuant to Section 8(a) of the International Banking Act of 1978 (the "IB Act") is also to be treated as a BHC. **Sec. 102(a) (p. 17)**. Note that this is the same definition used throughout the Act, including with regard to the definition of "banking entities" as used in the Volcker Rule discussions. Note that Section 8(a) of the IB Act provides that "(1) any foreign bank that maintains a branch or agency in a State, (2) any foreign bank or foreign company controlling a foreign bank that controls a commercial lending company organized under State law, and (3) any company of which any foreign bank or company referred to in (1) and (2) is a subsidiary shall be subject to the provisions of the Bank

[Footnote continued on next page]

subject to more stringent prudential standards and reporting requirements under Title I. All bank holding companies would be subject to Fed supervision under the Bank Holding Company ("BHC") Act , which is enhanced by various provisions of Title VI. Title I also includes the minimum holding company capital requirements added by and amendment offered by Senator Collins (R-ME) ("Collins Amendment"). In addition, a new Office of Financial Research in the Treasury Department would provide the Council with technical expertise and data collection support services.

Under Title I, the Fed will be responsible for establishing "more stringent" prudential standards than would apply to the Supervised NBFCs and to BHCs with assets of at least $50 billion ("Title I Companies"). It can also tailor requirements for these firms. The Fed has the authority to require reports from and conduct examinations of these companies, as well as apply early remediation requirements in the case of a company experiencing financial distress. If the Fed determines that such a large, complex company poses a grave threat to the financial stability of the United States, with a two-thirds vote of the Council it could require such company to take mitigatory action such as divesting subsidiaries, selling assets, or limiting activities.

The Council's authority is somewhat restricted compared to what it would have been under the House Bill, H.R. 4173. For example, under the final Act, most significant actions by the Council, such as subjecting a NBFC to the Fed's supervision, require a two-thirds vote including the affirmative vote of the Secretary of the Treasury (the "Secretary"), rather than a simple majority. Further, under H.R. 4173, the Council would have had the potential authority to subject any BHC to stricter prudential regulations if it was deemed necessary to mitigate risk to the financial system, not just those with assets greater than $50 billion.

Note that the effective dates FOR ALL PROVISIONS OF THE ACT is one day after date of enactment, unless otherwise specified. Sec. 4 (p. 16).

B. Highlights

1. The Council will recommend prudential standards "more stringent" than currently applicable to BHCs and NBFCs generally, including capital, liquidity, resolution plan, and risk-management standards, for Supervised NBFCs and "large, interconnected" BHCs (generally at least $50 billion in assets), to be implemented by the Fed. The Fed is to implement these standards through regulations within 18 months of enactment, but has discretion to act more quickly.

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Holding Company Act." Thus, while Section 8(a) of the IB Act does not "treat as a bank holding company" such foreign banks, it does "subject" them to the BHC Act.

2. A firm that is not a BHC and derives at least 85% of its consolidated revenues or assets from "financial" activities is a NBFC. A NBFC is only subject to regulation if the Council designates it as a Supervised NBFC based upon statutory factors. Under an "evasion" provision, financial activities of other companies may be subjected by the Council to prudential supervision under Title I.

3. The Fed can require any Supervised NBFC or any company subject to an evasion determination to establish an IHC for financial activities; an IHC established pursuant to an "evasion" determination will be a Supervised NBFC regulated by the Fed.

4. The stringency of these new standards is to increase based upon factors set forth in Title I. The title also provides that, based on Council recommendations, the Fed may tailor the stringency of the Title I standards applicable to each BHC or Supervised NBFC under this regime; the Fed also can limit expansion and potentially risky activities.

5. The Collins Amendment requires capital rules for depository holding companies applying standards that are "not less than" the minimum generally-applicable capital standards for banks, thus excluding trust preferred securities. These requirements will be phased in over approximately five years; an exclusion for smaller companies is provided.

6. *Effective Date*. Under Title I, the Council is created on the date of enactment and is to meet quarterly. Title I does not specify when the Council is to make determinations regarding firms to be Supervised NBFCs or to make its recommendations regarding heightened standards. The Fed is responsible for implementing the more stringent prudential standards under Title I. It must adopt such regulations within 18 months of the effective date. The Collins Amendment concerning capital standards takes effect for affected companies when the Fed adopts implementing rules, but includes a phase-in of approximately five years.

C. Summary

1. The Financial Stability Oversight Council

a. Formation of the Council

The Council is established on the date of enactment of the Act. **Sec. 111(a) (p. 18)**.

b. **Structure of the Council**

Chaired by the Secretary, the Council is composed of 8 other "voting members" that are federal financial regulators,[2] an independent member with insurance expertise, and 5 nonvoting members.[3] The Council is required to meet no less frequently than quarterly and shall take action by majority vote unless otherwise required. **Sec. 111(e)-(f) (p. 20)**.

c. **Council Authority**

The Council is responsible for identifying and responding to emerging risks throughout the financial system. ***See*** **Sec. 112(a) (p. 20)**. The Council's responsibilities fall into three categories. First, the Council's broad mandate includes identifying both risks to the financial stability of the United States that could arise from the material financial distress or failure of large, interconnected BHCs and NBFCs, or that could arise outside the financial services marketplace. **Sec. 112(a)(1)(A) (p. 20)**. Second, the Council is to promote market discipline by eliminating the expectation on the part of shareholders, creditors, and counterparties that the Government will shield them from losses in the event of failure. **Sec. 112(a)(1)(B) (p. 20)**. Third, the Council is to respond to emerging threats to U.S. financial stability. **Sec. 112(a)(1)(C) (p. 21)**.

d. **Council Duties**

Title I sets forth a list of 14 separate duties to be performed by the Council, as follows:

i. Together with the Office of Financial Research (the "Office") (discussed in greater detail herein), collect information from

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2 In addition to the Secretary of the Treasury as Chair, the members include the Chairmen of the Fed, the FDIC, SEC, CFTC, and NCUA, the Comptroller of the Currency, the Director of the Bureau of Consumer Financial Protection, the Director of the Federal Housing Finance Agency, and an independent member with insurance expertise appointed by the President.

3 The nonvoting members of the Council are the Director of the Office of Financial Research, the Director of the Financial Insurance Office, a State insurance commissioner, a State banking supervisor, and a State securities commissioner. **Sec. 111(b)(2) (p. 19)**. Nonvoting members are not to be excluded from any proceedings of the Council except that the Chairperson may (on the vote of the member agencies) exclude them when needed to safeguard and promote the free exchange of confidential supervisory information. **Sec. 111(b)(3) (p. 19)**.

member agencies, other regulators, BHCs and NBFCs;

ii. Direct the Office to perform research and analysis on data in support of the Council;

iii. Monitor the financial services marketplace to identify potential threats to U.S. financial stability;

iv. Monitor domestic and international financial regulatory proposals and developments, including insurance and accounting issues, and advise Congress and make recommendations that will enhance the integrity, efficiency, competitiveness, and stability of the U.S. financial markets;

v. Facilitate information sharing and coordination among the member agencies and other federal and state agencies regarding domestic financial services policy development, rulemaking, examinations, reporting requirements, and enforcement actions;

vi. Recommend general supervisory priorities and principles reflecting the outcome of discussions among the member agencies;

vii. Identify gaps in regulation that could pose risks to U.S. financial stability;

viii. Require supervision by the Fed for NBFCs that may pose risks to U.S. financial stability in the event of their material financial distress or failure, or because of their activities;

ix. Make recommendations to the Fed concerning the establishment of heightened prudential standards for risk-based capital, leverage, liquidity, contingent capital, resolution plans and credit exposure reports, concentration limits, enhanced public disclosures, and overall risk management for Supervised NBFCs and large, interconnected BHCs;

x. Identify systemically important financial market utilities and payment, clearing, and settlement activities (as defined in Title VIII);

xi. Make recommendations to primary financial regulatory agencies to apply new or heightened standards and safeguards for financial activities or practices that could create or increase risks of significant liquidity, credit, or other problems spreading among BHCs, NBFCs, and U.S. financial markets;

xii. Review and (at the Council's discretion) submit comments to the SEC and any standard-setting body with respect to an existing or proposed accounting principle, standard, or procedure;

xiii. Provide a forum for discussion and analysis of emerging market developments, financial regulatory issues, and the resolution of jurisdictional disputes among the members of the Council; and

xiv. Annually report to and testify before Congress on the activities of the Council, significant financial market and regulatory developments, potential emerging threats to U.S. financial stability, all determinations made under Section 113 or Title VIII, all recommendations made under Section 119, and recommendations to U.S. financial markets, to promote market discipline, and to maintain investor confidence. **Sec. 112(a) (pp. 21-22)**.

e. Statements by Council Members

The Chairperson of the Council is required to appear before the House Financial Services and Senate Banking committees each year and discuss the efforts, activities, objective and plans of the Council. **Sec. 112(c) (p. 22)**. In addition, Title I requires that each Council member make an annual statement as to whether the Council is doing its job. At the time each annual report of the Council is submitted to Congress, each voting member of the Council is required to submit a signed statement to Congress stating whether such member believes the Council, Government and private sector are taking all reasonable steps to ensure financial stability and mitigate systemic risk and, if the member does not believe all reasonable steps are being taken, to state what actions the member believes should be taken. **Sec. 112(b) (p. 22)**.

f. Information Gathering

Title I grants the Council authority to obtain information from the Office, member agencies, and the Federal Insurance Office (the "FIO"). **Sec. 112(d) (p. 22)**. In addition, the Council, through the Office, can require the submission of periodic and other reports from NBFCs and BHCs, but must mitigate this reporting burden by coordinating with the company's primary financial regulatory agency and rely on information available from such agencies. In addition, in the case of foreign financial companies, the Council is required to mitigate the reporting burden by consulting with the appropriate foreign regulators and rely on information already conducted by them. **Sec. 112(d)(2) and (3) (p. 23)**.

2. Examination by the Fed

If the Council is unable to determine whether the financial activities of a U.S. NBFC pose a threat to U.S. financial stability based on information or reports obtained by it, then the Council may request the Fed, and the Fed is authorized, to conduct an examination of the U.S. NBFC for the sole purpose of determining whether it should be supervised by the Fed. **Sec. 112(d)(4) (p. 23)**.

3. GAO Audit of Council

The Comptroller General may audit the activities of the Council and any person acting under its authority and, if it does so, then the Comptroller General will have access to information of the Council including any records or other information under its control or used by it, any records or other information under the control of a person or entity acting on the Council's behalf, and officers, directors, employees, financial advisors, staff, working groups, and agents and representatives of the Council. **Sec. 122 (pp. 37-38)**.

D. Nonbank Financial Companies

1. Definition of Nonbank Financial Company

Title I establishes a threshold definition for an NBFC—as a company that derives at least 85% of its annual gross revenue or consolidated assets from financial activities (as defined in Section 4(k) of the BHC Act), including any depository institutions. Only certain, systemically-significant (as determined by application of the factors listed below) NBFCs will be subject to regulation by the Fed. **Sec. 102(a)(4) (p. 21) and Sec. 102(a)(6) (p. 22)**.

This definition of NBFC includes domestic and foreign firms. A NBFC can either be a Foreign Nonbank Financial Company (defined in Section 102(a)(4)(A) (p. 17) as companies organized outside of the United States) or a U.S. NBFC (defined in Section 102(a)(4)(B) (p. 17) as companies organized under U.S. or any State law). In either case the entity must be "predominantly engaged in" financial activities. "Predominantly engaged" is defined in Sec. 102(a)(6) to mean that either the annual gross revenues of it and all of its subsidiaries are derived from activities that are financial in nature (as defined in BHC Act Section 4(k)) and from the ownership or control of insured depository institutions represent 85% or more of the company's consolidated annual gross revenue[4] or that the consolidated assets of the company and all of its subsidiaries related to Section 4(k) activities and the ownership or control of insured depository institutions represents 85% or more of the consolidated assets of the company.[5] **Sec. 102(a)(6)**

4 Note that this definition reflects that activities defined in Section 4(k) of the BHC Act do not including "banking activities" and thus that it is necessary to list banking activities as a financial activity separately. This is a change—and an improvement—over some earlier versions of the legislation which failed to recognize or omitted this distinction.

5 Note that because different categories of assets generate different revenue yields, applying an 85% test to both the balance sheet and income statement items will yield different results. Since this is an "or" test rather than an "and" test the result is a broader

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(p. 18). The Fed is directed to establish regulations setting the requirements for determining if a company is "predominantly engaged" in financial activities. **Sec. 102(b) (p. 18)**.

The sub-definitions of "Foreign NBFC" and "U.S. NBFC" are noteworthy because while both are "NBFCs," they each exclude certain classes of companies. "Foreign NBFCs" specifically do not include companies that are or are treated as BHCs in the United States. "U.S. NBFCs" exclude BHCs and also exclude Farm Credit System institutions, national securities exchanges (or a parent of one), clearing agencies (or parent of one), security-based swap execution facilities (or security-based swap data repositories registered with the SEC), boards of trade designated as a contract market (or parent of one), derivatives clearing organizations (or parent of one), or swap execution facilities (or swap data repositories registered with the CFTC). Note that these carve outs have particular impact in specific titles of the Act, including in Title VII regulating derivatives.

2. Supervised NBFCs

The Council "may" determine, by a two-thirds vote of its members, which U.S. NBFCs will become Supervised NBFCs subject to the Title I regime. In making this determination, the Council <u>must</u> consider the following factors:

i. The extent of leverage of the company;

ii. The extent and nature of the off-balance-sheet exposures of the company;

iii. The extent and nature of the transactions and relationships of the company with other significant NBFCs and significant BHCs;

iv. The importance of the company as a source of credit for households, businesses, and State and local governments and as a source of liquidity for the U.S. financial system;

v. The importance of the company as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities;

vi. The extent to which assets are managed rather than owned by the

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definition of NBFC. In some earlier versions of the legislation only a revenue test was proposed.

company, and the extent to which ownership of assets under management is diffuse;

vii. The nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;

viii. The degree to which the company is already regulated by one or more primary financial regulatory agencies;

ix. The amount and nature of the financial assets of the company;

x. The amount and types of the liabilities of the company, including the degree of reliance on short-term funding; and

xi. Any other risk-related factors the Council deems appropriate. **Sec. 113(a)(2) (p. 24)**.

The Council may make the same determination with regard to Foreign NBFCs, except that the considerations it is required to take into account generally relate to the U.S. operations of the company—including the effect on underserved communities in the United States and the amount and nature of financial assets in the United States. ***See*** **Sec. 113(b) (p. 25)**.

3. Anti-evasion

Under an "anti-evasion" provision, the Council has discretion to determine (on its own initiative or at the request of the Fed, and by a two-thirds vote including the vote of the Chairperson) that with regard to any "company incorporated or organized under the laws of the United States or any State or the financial activities in the United States of a company incorporated or organized in a country other than the United States," such company's "nature, scope, size, scale, concentration, interconnectedness, or mix of" financial activities conducted directly or indirectly by it would pose a threat to U.S. financial stability. In that case, the Council can find that it operates in a manner that evades application of Title I and subject the company to Fed supervision and prudential standards. **Sec. 113(c) (pp. 25-26)**.

Under this provision the Council has discretion to subject financial activities of a company that is not "predominantly financial" to prudential standards and Fed supervision under Title I. It would appear that the requirement that the company is "organized or operates in a manner so as to evade" the application of Title I could be read to mean that the activity is not conducted in what under the title is defined as a NBFC. **Sec. 113(c) (pp. 25-26)**. After the Council determination under this provision, then the company may on its own establish an IHC in which "the financial activities of such company and its subsidiaries shall be conducted."[6] This IHC is then subject to Fed supervision and to prudential standards as if it were a Supervised NBFC. In addition, the Fed may require that the company establish an IHC in order to facilitate the supervision of the financial activities of the company, in which case, again, the IHC will be a Supervised NBFC subject to Fed supervision and prudential standards. **Sec. 113(c)(3) (p. 26)**.

Note that only the "financial activities" of a company subject to the anti-evasion provision are subject to prudential supervision.[7] Nonfinancial activities "shall not" be subject to Fed supervision. **Sec. 113(c)(6) (p. 27)**. This provision applies only to "the company" subject to a anti-evasion determination by the Council, meaning that the company is not a NBFC. However, there is tension between this broad statement and the fact that Supervised NBFC are treated differently in that a Supervised NBFC may have up to 15% of its assets or revenues derived from nonfinancial activities.

4. Opportunities To Rescind or Appeal a Council Decision

A determination by the Council that a NBFC is to be supervised by the Fed (but apparently not a decision to subject a company that is not a NBFC to an anti-evasion determination and supervision) may be reevaluated by the Council or appealed by the company. The Council is required to reevaluate its decisions to subject a NBFC to Fed supervision at least annually, and to rescind the decision by a two-thirds vote of members including the Chairperson where the Council determines the NBFC no longer meets the standards for Fed supervision. **Sec. 113(d)(p. 27)**. In addition, the Council must provide a NBFC written notice of a proposed determination to subject it to Fed supervision, in which case the NBFC has 30 days to request in writing a written or oral hearing to contest the proposed determination, and after receipt of which the Council must fix a hearing time and place that is not later than 30 days after the date it received the request. Within 60 days of the hearing, the Council must notify the NBFC of its final decision. If the NBFC did not request a hearing then the Council must notify the NBFC of its determination within 10 days of the date by which the company could have requested a hearing. **Sec. 113(e) (pp. 27-28)**.

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6 Note that activities described in Section 167(b)(2) of the Act need not be conducted in the IHC.

7 The term "financial activities" is defined, in this context, to mean activities of a financial nature as defined in Section 4(k) of the BHC Act and ownership or control of insured depository institutions, but for this purpose excludes internal financial activities conducted for the company or an affiliate, including internal treasury, investment, and employee benefit functions. **Sec. 113(c)(5) (pp. 26-27)**.

5. Emergency Designation

The Council is permitted to waive the notice and hearing requirements if it determines by a two-thirds vote (including the Chairperson) that waiver is needed to prevent or mitigate threats posed by the NBFC to U.S. financial stability. In this case the Council is required to give the NBFC notice of the waiver within 4 hours after it is granted. If the NBFC is a foreign NBFC, then the Council is required to consult with the company's home country supervisor. In either case, the Council must give the NBFC an opportunity to request a hearing to contest the waiver or modification within 10 days of the date the notice of waiver was provided to the NBFC. In that case the Council has 15 days after the date of receipt of the request to set a hearing and must notify the NBFC of its final determination within 30 days of the hearing. **Sec. 113(f) (p. 28)**.

6. Judicial Review

A final determination by the Council is not the last opportunity for a NBFC to contest the Council's action. A NBFC has 30 days after the receipt of a final determination to bring an action in a U.S. district court either in the judicial district where the home office of the NBFC is located or in the U.S. District Court for the District of Columbia (the "Court") for an order requiring that the final determination be rescinded. The Court's options are limited to two: it is required to either dismiss the action or direct the final determination to be rescinded. The standard of review for the court is whether the Council's decision was "arbitrary and capricious"—a very high standard for any NBFC to satisfy. **Sec. 113(h) (pp. 28-29)**.

7. Safe Harbor

The Fed must issue regulations in consultation with the Council setting criteria for exempting certain types of U.S. and foreign NBFCs from Fed supervision. **Sec. 170(a) (p. 61)**. In developing criteria under this section, the Fed must take into account the criteria used for determining whether to subject a NBFC to Fed supervision. **Sec. 170(b) (p. 61)**. The Fed, in consultation with the Council, must review the regulations used to exempt NBFCs from supervision at least once every five years, but such revisions will not take effect for two years from their date of publication. **Sec. 170(d) (p. 62)**. The Chairman of the Fed and the Chairperson of the Council must submit a joint report to Congress within 30 days of the date final regulations are issued (or revisions are subsequently issued) that explains the rationale for exemption. **Sec. 170(e) (p. 62)**.

8. Supervised NBFC Registration

Within 180 days of being designated by the Council as a Supervised NBFC, the company must register with the Fed on forms prescribed by the Fed. **Sec. 114 (p. 28)**.

9. Enforcement Against Supervised NBFCs

A Supervised NBFC and any subsidiaries (other than a depository institution subsidiary) is subject to Sections 8(b) through (n) of the Federal Deposit Insurance Act ("FDI Act") as if it were a BHC. **Sec. 162(a) (p. 48)**. If the Fed determines a practice of a depository institution subsidiary or functionally regulated subsidiary of a Supervised NBFC poses a threat to U.S. financial subsidiary or does not comply with Fed regulations, it may recommend in writing that the primary financial regulatory agency for the subsidiary initiate action or enforcement proceedings. **Sec. 162(b)(1) (p. 48)**. If the primary regulator fails to take acceptable action within 60 days of the date of the recommendation, then the Fed (upon a vote of its members) may take the recommended supervisory or enforcement action as if the subsidiary were a BHC. **Sec. 162(b)(2) (p. 48)**.

10. Reports By and Examinations Of Supervised NBFCs

Reports. The Fed may require any Supervised NBFC (and any of its subsidiaries) to submit reports to keep the Fed informed as to the financial condition of the company, systems of the company for monitoring and controlling risks, and the extent to which activities post a threat to U.S. financial stability. **Sec. 161(a)(1) (p. 47)**. The Fed is required to use existing reports and supervisory information provided to federal and state regulators, audited financial statements, and other publicly available information to the fullest extent possible. **Sec. 161(a)(2) (p. 47)**.

Examinations. The Fed may examine any Supervised NBFC and any subsidiary to inform the Fed of the nature and operations of the company; the financial, operational, and other risks the company may pose to U.S. financial stability or the safety and soundness of the company; systems for monitoring risks; and compliance with law. **Sec. 161(b)(1) (p. 47)**. The Fed is required to use the reports of examinations of any subsidiary depository institution or functionally regulated subsidiaries to the fullest extent possible. **Sec. 161(b)(2) (pp. 47-48)**.

11. Management Interlocks Prohibition

Supervised NBFCs will also be treated as a BHC for purposes of the Depository Institutions Management Interlocks Act, and the Fed may not grant waivers for interlocks involving Supervised NBFCs and BHCs over $50 billion. **Sec. 164 (p. 49)**.

E. Stricter Prudential Regulation by the Fed

1. Risk Mitigation Standards

The Fed, on its own or based on Council recommendations (under Section 115), is required to establish prudential standards for Title I Companies.[8] The purpose is to prevent or mitigate risks to U.S. financial stability that could arise from the material distress or failure, or from the ongoing activities, of these large, interconnected financial institutions. **Sec. 165(a)(1)**

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[8] The Council may recommend that this asset threshold be made higher than $50 billion for the application of any individual standard applied by the Fed. **Sec. 115(a)(2)(B) (p. 29)**. The Council has authority to adjust this threshold above $50 billion pursuant to such a Council recommendation. **Sec. 165(a)(2)(B) (p. 50)**.

(p.50). For the same purpose, the Council "may" make recommendations to the Fed concerning establishing and refining prudential standards and reporting and disclosure requirements applicable to Title I Companies. **Sec. 115(a)(1) (p. 29)**.

The parallel nature of Section 115 and Section 165 of the Act reflect that the Council does not have direct regulatory authority itself, and for this reason is limited to making recommendations to the Fed regarding the "more stringent" prudential standards. In making these recommendations, the Council may differentiate among companies that are subject to heightened standards on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities (including of their subsidiaries), size, and any other factors the Council deems appropriate. **Sec. 115(a)(2) (p. 29)**. In addition, the prudential standards recommended by the Council may include risk-based capital requirements, leverage limits, liquidity requirements, resolution plan and credit exposure report requirements, concentration limits, a contingent capital requirement, enhanced public disclosures, short-term debt limits, and overall risk management requirements. **Sec. 115(b)(1) (pp. 29-30)**.

2. Heightened Standards Applicable to Activities or Practices

Council Recommendations. Title I provides for applying heightened standards to activities or practices, as opposed to companies. The Council may also provide for more stringent regulation of a specific financial activity by issuing recommendations to the primary financial regulatory agencies to apply heightened standards for a financial activity or practice conducted by BHCs or NBFCs if the Council determines the activity could increase risk of significant liquidity, credit, or other problems spreading among BHCs and NBFCs; U.S. financial markets; or low-income, minority, or underserved communities. **Sec. 120(a) (p. 35).**

Consultation and Costs. The Council must consult with the primary financial regulator and provide public notice and opportunity to comment on any proposed recommendation that the primary financial regulator apply heightened standards for a financial activity or practice. The heightened standards must take costs to long-term economic growth into account and may include either prescribing the conduct of the activity only in specific ways or prohibiting the activity entirely. **Sec. 120(b) (p. 35)**.

Imposition of Standards. Each primary financial regulatory agency must impose the standards recommended by the Council or explain in writing to the Council within 90 days of the date the Council issues the recommendation why the agency has not followed the recommendation of the Council. **Sec. 120(c) (pp. 35-36)**.

Reports to Congress. The Council must report to Congress on any recommendations it issues to apply heightened standards to individual activities or practices, whether the primary financial regulatory agency implemented the recommendations, and any recommendations for legislation. **Sec. 120(d) (p. 36)**.

Rescission and Appeal. The Council may recommend to the primary financial regulatory agency that its recommendation that a financial activity or practice be subject to standards or safeguards be rescinded, but it is up to the primary financial regulatory agency to determine whether the standard should remain in effect. Each primary financial regulatory agency must establish procedures under which entities under its jurisdiction can appeal a determination to apply heightened standards to an activity or practice. **Sec. 120(e) (p. 36)**.

3. More Stringent and Increasingly Stringent

The Fed is required to ensure that the prudential standards applied to Title I Companies are "more stringent" than the standards applicable to NBFCs and BHCs that do not present similar risks to the financial stability of the United States, and the Council may make recommendations regarding these prudential standards to the Fed. **Sec. 165(a)(1)(A) (p. 50) and Sec. 115(a)(1)(A) (p. 29)**. In addition, the Fed must apply increasingly stringent prudential standards as Title I Companies become increasingly large, complex, and risky. **Sec. 165(a)(1)(B) (p. 50)**. These standards are to increase in stringency based on:

i. The extent of the leverage of the company;

ii. The extent and nature of off-balance-sheet exposures;

iii. The extent and nature of transactions and relationships with other significant NBFCs and significant BHCs;

iv. The importance of the company as a source of credit for low-income, minority, or underserved communities and the impact of failure on such communities;

v. The extent to which assts are managed rather than owned and the extent to which owned assets are diffuse;

vi. The nature, scope, size, scale, concentration, interconnectedness, and mix of activities;

vii. The degree to which the company is already regulated;

viii. The amount and nature of the financial assets of the company;

ix. The amount and types of liabilities of the company and reliance on short-term funding;

x. Whether the company owns an insured depository institution;

xi. The nonfinancial activities and affiliates of the company; and

xii. Any other risk-related factors the Fed deems appropriate. **Sec. 115(a)(1)(B) (p.29), Sec. 165(a)(1)(B) (p. 50), Sec. 115(b)(3) (p. 30), and Sec. 165(b)(3) (p. 51)**.

4. Stability

Both the Council and the Fed are required to ensure that small changes in the factors impacting these prudential standards to do not result in "sharp, discontinuous" changes in the standards. **Sec. 115(b)(3)(B) (p. 30) and Sec. 165(b)(3)(B) (p. 51)**.

5. Tailored Application

The Fed must apply increasingly stringent prudential standards, which may be differentiated among companies on an individual basis or by category, taking into account the following considerations:

i. Capital structure;

ii. Riskiness;

iii. Complexity;

iv. Financial activities (including of subsidiaries);

v. Size; and

vi. Any other risk-related factors the Fed deems appropriate. **Sec. 165(a)(2)(A) (p. 50)**.

6. Development of Prudential Standards

The Fed <u>must</u> establish prudential standards that include:

i. Risk-based capital requirements and leverage limits (unless the Fed determines other standards are more appropriate);

ii. Liquidity requirements;

iii. Overall risk management requirements;

iv. Resolution plan and credit exposure report requirements; and

v. Concentration limits. **Sec. 165(b)(1)(A) (pp. 50-51)**.

In addition, the Fed <u>may</u>, at its discretion, establish additional prudential standards that include:

i. Contingent capital requirements;

ii. Enhanced public disclosures;

iii. Short-term debt limits; and

iv. Other prudential standards that the Fed determines necessary or the Council recommends to the Council (under Section 115). **Sec. 165(b)(1)(B) (p. 51)**.

7. Foreign Financial Companies

In making recommendations that would apply to foreign nonbank financial companies supervised by the Fed or foreign-based BHCs, the Council is to give due regard to principles of national treatment and competitive equity. The Fed is to give the same due regard to principles of national treatment and competitive equity in applying these standards. **Sec. 165(b)(2) (p. 51)**.

Note also that, as a general matter, for purposes of the application of the subtitles related to the authority of the Council (Section 111 through Section 123) and related to the authority of the Fed over NBFCs and BHCs (Section 161 through Section 176), that (other than in Section 113(b)) with respect to a foreign NBFCs, the Act covers only the United States activities and subsidiaries of such foreign companies. **Sec. 102(c) (p. 18)**. Section 113(b) provides that the Council may (by a two-thirds vote including the Chairperson) determine that a foreign NBFC is to be supervised by the Fed and subject to prudential standards (because material financial distress of the company and its nature, scope, size, scale, concentration, interconnectedness, or mix of activities could threaten United States financial stability). **Sec. 113(b) (p. 25)**. Thus, while all of the activities of a foreign NBFC are to be considered in determining whether the foreign company poses a risk to U.S. financial stability (and should therefore be supervised by the Fed), only the activities of the company in the United States and those conducted by its U.S. subsidiaries will be regulated.

8. Contingent Capital

After submission of a report to Congress of a study conducted by the Council, the Fed may adopt contingent capital requirements for Title I Companies designed to "maintain a minimum amount of long-term hybrid debt that is convertible to equity in times of financial stress." **Sec. 165(c)(1) (p. 52)**. In issuing these regulations the Fed must consider the Council's report, an appropriate transition period for implementing contingent capital, all the considerations going into prescribing tailored prudential standards, the entity's capital requirements, and any other factors the Fed deems appropriate. **Sec. 165(c)(2) (p. 52)**.

The Council is required to conduct a study—and report to Congress within 2 years of enactment—of the feasibility, benefits, costs and structure of a contingent capital requirement on Supervised NBFCs and large, interconnected BHCs. The study is to include an evaluation of the degree such requirements would enhance safety and soundness, promote U.S. financial stability, and reduce risks to U.S. taxpayers. It must also evaluate the characteristics and amounts of contingent capital to be required, analyze potential prudential standards that should be used to determine whether contingent capital would be converted to equity in times of financial stress, evaluate the cost to companies and the effects on the financial markets of requiring contingent capital, and evaluate the effects on international competitiveness of companies subject to the requirement. **Sec. 115(c) (pp. 30-31)**.

9. Resolution Plans and Credit Exposure Reports

Resolution Plans. The Fed must require all Title I Companies to prepare orderly resolution plans, sometimes called a "living will," to plan for the event of material financial distress or failure. Each such plan must include:

i. Information regarding the manner and extent to which any insured depository institution affiliated with the company is adequately protected from risks arising from the activities of any nonbank subsidiaries of the company;

ii. Full descriptions of the ownership structure, assets, liabilities, and contractual obligations of the company; identification of the cross-guarantees tied to different securities; identification of major counterparties; and a process for determining to whom the collateral of the company is pledged; and

iii. Any other information that the Fed and the FDIC jointly require by rule or order. **Sec. 165(d)(1) (p. 52)**.

Credit Exposure Reports. The Fed must also require that each Title I Company submit a periodic report to the Fed, Council and FDIC on the nature and extent to which the company has credit exposure to other significant NBFCs and significant BHCs and also the nature and extent to which other significant NBFCs and BHCs have credit exposure to it. **Sec. 165(d)(2) (P. 53)**.

Each orderly resolution plans and credit exposure reports will be reviewed by the Fed and FDIC. **Sec. 165(d)(3) (p. 53)**. If these agencies jointly determine that a resolution plan of a Title I Company is not credible or would not facilitate an orderly resolution of the company in bankruptcy, then the Fed and FDIC must notify the company of the deficiencies and the company must revise and resubmit the plan. **Sec. 165(d)(4) (p. 53)**. If a re-submitted plan is not viewed as credible by these agencies, they may impose requirements or restrictions on capital, leverage, liquidity, growth, or operations. **Sec. 165(d)(5)(A) (p. 53)**.

Divestiture. In addition, the Fed and the FDIC, in consultation with the Council, may jointly direct a Title I Company to divest assets or operations in order to facilitate an orderly resolution in the event of failure if the Fed and FDIC have jointly imposed more stringent requirements on the company and the company has failed, within 2 years, to resubmit a resolution plan with the required revisions. **Sec. 165(d)(5)(B) (pp. 53-54)**.

The Fed and FDIC must issue regulations implementing this provision within 18 months of enactment. However, the statute does not specify when resolution plans must be first submitted. **Sec. 165(d) (p. 52)**. Also, note that the Council "may" make recommendations to the Fed concerning the requirement that a Title I Company report periodically on their plans for rapid and orderly resolution in the event of material financial distress or failure. **Sec. 115(d) (pp. 31-32)**.

10. Concentration Limits

The Fed is required to adopt regulations limiting the credit exposure of Title I Companies to an unaffiliated firm to 25% of capital stock and surplus, unless the Fed prescribes a lower percentage. A transaction between a covered company and any person is a transaction with the covered company if the proceeds of the transaction benefit, or are transferred to, that company. A transition period of three years (which the Fed may extend for 2 additional years) from the date of enactment applies. In addition, the Fed may grant exemptions. **Sec. 165(e) (p. 54)**. Note that the Council "may" make recommendations to the Fed concerning the standards to limit concentration risk for Title I Companies. **Sec. 115(e) (p. 32)**. For purposes of this provision, "credit exposure" is broadly defined and means:

i. All extensions of credit to the company, including loans, deposits, and lines of credit;

ii. All repurchase agreements and reverse repurchase agreements with the company, and all securities borrowing and lending transactions with the company, to the extent that such transactions create credit exposure for the Title I;

iii. All guarantees, acceptances, or letters of credit (including endorsement or standby letters of credit) issued on behalf of the company;

iv. All purchases of or investment in securities issued by the company;

v. Counterparty credit exposure to the company in connection with a derivative transaction between the Title I Company and the company; and

vi. Any other similar transactions that the Fed, by regulation, determines to be a credit exposure. **Sec. 165(e)(3) (pp. 54-55)**.

11. Enhanced Public Disclosures

The Fed may prescribe periodic public disclosures for Title I Companies to "support market valuation of the risk profile, capital adequacy, and risk management capabilities" of the company. **Sec. 165(f) (p. 55)**.

The Council may make recommendations to the Fed to require periodic public disclosures by Title I Companies in order to support market evaluation and risk profile, capital adequacy, and risk management capabilities. **Sec. 115(f) (p. 32)**.

12. Short-Term Debt Limits

The Fed may, by regulation, prescribe a limit on the amount of short-term debt, including off-balance sheet exposures, that may be accumulated by Title I Companies. **Sec. 165(g) (p. 55).** The Council may make recommendations to the Fed to require short-term debt limits to mitigate risks that an over-accumulation of such debt could pose a risk to such companies or the financial system. **Sec. 115(g (p. 32)**. Such limit must be based on the short term debt of the company as a percentage of the capital stock and surplus of the company. **Sec. 165(g)(2) (p. 55)**. For this purpose, "short-term debt" is defined to mean liabilities with short-dated maturities that the Fed identifies by regulation, and excluding any insured deposits. **Sec. 165(g)(3) (p. 55)**. The Fed has both rulemaking and exemption granting authority with regard to the imposition of short-term debt limits. **Sec. 165(g)(4) and (5) (p. 56)**.

13. Risk Committee

Each Supervised NBFC that is publicly traded will be required to establish a risk committee within 1 year of the date it receives notice that it is supervised by the Fed. BHCs that are publicly traded and have consolidated assets of $10 billion or more must also establish a risk committee. The Fed may, at its discretion, require that BHCs that are publicly traded and have less than $10 billion in assets establish a risk committee. The risk committee is required to oversee the financial institution's risk management practices, include a number of independent directors determined by the Federal Reserve, based on the nature of operations, size of assets and other criteria, and include at least one risk management expert with experience in identifying, assessing and managing risk at large, complex financial institutions. This provision differs from one proposed in an earlier version of the legislation considered by the U.S. Senate, which would have required that the boards of all listed public companies, with limited exceptions, form a separate risk committee composed solely of independent directors. The risk committee provision will not affect the vast majority of public companies, many of which currently address risk through the full board or another board committee. Although the SEC adopted rules in December 2009 requiring companies to disclose the extent of the board's role in the company's risk oversight,[9] most companies did not form risk oversight committees but instead delegate responsibility for risk oversight among the board committees and the full board. The Fed is required to issue final rules implementing the risk committee requirements within 12 months of the transfer date, to take effect no later than 15 months after the transfer date. **Sec. 165(h) (p. 56).**

14. Stress Tests

Fed Tests. The Fed (in coordination with the appropriate primary financial regulatory agencies) is required to conduct annual stress tests of Title I Companies to determine whether such companies have the capital necessary to absorb losses as a result of adverse economic conditions. **Sec. 165(i)(1)(A) (pp. 56-57).** The Fed is to provide at least 3 different sets of test conditions (baseline, adverse, and severely adverse) and may require the tests be conducted for all BHCs and NBFCs in addition to Title I Companies. The Fed must also require Title I companies to update their rapid resolution plans based on the results of stress tests. **Sec. 165(i)(1)(B) (p. 57)**.

Company Tests. Title I Companies must conduct their own semi-annual stress tests and all other financial companies with consolidated assets of more than $10 billion that are regulated by a primary Federal financial regulatory agency must conduct annual stress tests. These companies must submit a report to the Fed and to the primary federal regulatory agency on the

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[9] See the SEC's Release No. 33-9089, issued December 16, 2009, available here.

tests containing information "as the primary financial regulatory agency shall require." **Sec. 165(i)(2)(A) and (B) (p. 57)**. Each federal primary financial regulatory agency—in coordination with the Fed and the FIO—must issue comparable regulations implementing the company stress test requirement, including defining "stress test," establishing methodologies for conducting tests with 3 sets of conditions, and establishing the form and content of the required reports. **Sec. 165(i)(2)(C) (pp. 57-58)**.

15. Leverage Limitation

Title I Companies are required to maintain a debt to equity ratio of no more than 15 to 1, upon a determination by the Council that the company poses a grave threat to financial stability and the imposition of such requirement is necessary to mitigate risk. The Fed is required to promulgate implementing regulations and timelines for compliance. **Sec. 165(j) (p. 58).**

16. Inclusion of Off-Balance-Sheet Activities in Computing Capital Requirements

The computation of capital for the purposes of meeting capital requirements for any Title I Company must take into account any off-balance-sheet activities. However, the Fed has discretion to exempt companies or any transaction or transactions from this requirement. For these purposes, "off-balance-sheet activities" is defined as "an existing liability of a company that is not currently a balance sheet liability, but may become one upon the happening of some future event". **Sec. 165(k) (p. 58)**. The definition then goes on to list the following non exclusive list of "future events":

i. Direct credit substitutes in which a bank substitutes its own credit for a third party, including standby letters of credit;

ii. Irrevocable letters of credit that guarantee repayment of commercial paper or tax-exempt securities;

iii. Risk participations in bankers' acceptances;

iv. Sale and repurchase agreements;

v. Asset sales with recourse against the seller;

vi. Interest rate swaps;

vii. Credit swaps;

viii. Commodities contracts;

ix. Forward contracts;

x. Securities contracts; and

xi. Such other activities or transactions as the Fed may, by rule, define. **Sec. 165(k) (pp. 58-59)**.

17. Limitations on Acquisitions

A Title I Company is not permitted to acquire ownership or control of any company with assets of $10 billion or more that is engaged in financial activities (under Section 4(k) of the BHC Act) without providing prior notice to the Fed. **Sec. 163 (pp. 48-49)**. Specifically, Supervised NBFCs are treated as BHCs for purposes of Section 4 of the BHC Act. **Sec. 163(a) (p. 48)**. In addition, a Title I Company may not acquire control of any voting shares of a company engaged in Section 4(k) financial activities with assets of $10 billion or more without providing advance written notice to the Fed. **Sec. 163(b)(1) (p. 49)**. Note, however, that this notice requirement does not apply to acquisitions under Section 4(c) or Section 4(k)(4)(E) of the BHC Act. **Sec. 163(b)(2) (p. 49)**. The Fed is to consider the extent to which the proposed acquisition would result in greater concentrated risks to global or U.S. financial stability. **Sec. 163(b)(4) (p. 49)**.

18. Remedial Action

The Fed, in consultation with the Fed and FDIC, must prescribe regulations providing for the early remediation of financial distress in a Title I Company but provides specifically that nothing in the provision can authorize financial assistance from the Federal Government. **Sec. 166(a) (p. 59)**. The purposes of these regulations is to establish "a series of specific remedial actions to be taken by a [Title I Company] that is experiencing increasing financial distress." **Sec. 166(b) (p. 59)**. Specifically, the regulations need to define measures of the financial condition of the company including regulatory capital, liquidity measures, and forward-looking indicators and establish requirements that increase in stringency as financial condition deteriorates. **Sec. 166(c) (p. 59)**.

The Council and the Fed can take aggressive remedial action against a company that poses a meaningful threat to U.S. financial stability. If the Fed determine that a Title I Company poses such a "grave thereat" to the financial stability of the United States, the Fed upon a two-thirds vote of the Council <u>must</u> take at least one of the following five actions:

i. limit the ability of the company to merge with, acquire, consolidate with, or otherwise become affiliated with another company;

ii. restrict the ability of the company to offer a financial product or products;

iii. require the company to terminate one or more activities;

iv. impose conditions on the manner in which the company conducts 1 or more activities; or

v. if the Fed determines that the none of these four actions described are inadequate to mitigate a threat to the financial stability of the United States in its recommendation, require the company to sell or otherwise transfer assets or off-balance-sheet items to unaffiliated entities. **Sec. 121(a) (pp. 36-37)**.

Companies subject to this remedial action have the opportunity to appeal the decision of the Fed and Council through notice and hearing. The Fed and Council must give such a company written notice of the action being considered, including the basis for it. The company then has 30 days from the receipt of this notice to request a written or oral hearing, which the Fed must schedule for a date within 30 days of its receipt of a timely request. Within 60 days of the hearing date (or within 60 days of the provision of notice if no hearing was scheduled) the Fed must notify the company of its final decision. In making its decision the Fed and Council are to take into consideration the factors considered when determining whether to subject a NBFC to Fed supervision. In addition, if the Fed is considering applying this provision to foreign companies, then it must give due regard to the principals of national treatment and equality of competitive opportunity and also take into account the extent to which the company is subject to regulation in its home country. **Sec. 121(b)-(d) (p. 37)**.

F. Minimum Leverage and Risk-Based Capital Requirements

Title I includes multiple provisions addressing capital requirements, as does Title VI. The Title I capital requirement provisions are discussed below.

1. Leverage Limits and Risk-Based Capital Requirements

Under the prudential standards requirements, the Fed is required (in consultation with the Council) to adopt capital rules for Title I Companies, including leverage limits and risk-based capital requirements. These requirements must be "more stringent" than those applied to other NBFCs and BHCs and "increase in stringency" based on the extent of the applicability of the considerations used for designation of Supervised NBFCs. **Sec. 115(a)(1) (p. 29)**.

2. Debt to Equity Limits

As discussed under "prudential standards," a Title I Company will be required to maintain a debt to equity ratio of no more than 15 to 1 upon a determination by the Council that the company poses a grave threat to financial stability and the imposition of this requirement is needed to mitigate risk. **Sec. 165(j) (p. 58).**

3. Contingent Capital Requirements

Also as discussed under "prudential standards," subsequent to a study conducted by the Council, the Fed may adopt contingent capital requirements for Title I Companies, designed to "maintain a minimum amount of long-term hybrid debt that is convertible to equity in times of financial stress." **Sec. 165(c)(1) (p. 52)**.

4. Leverage and Risk-Based Capital Requirements

Under the "Collins Amendment," set out in Section 171, the appropriate Federal banking agencies must establish minimum leverage capital and risk-based capital requirements for insured depository institutions, BHCs, SLHCs and Supervised NBFCs. For this purpose "leverage capital" refers to the ratio of tier 1 capital to total average assets. These capital requirements may "not be less than" the minimum generally applicable capital standards for banks as of the date of enactment, applying the standards and measures under the prompt corrective action regulations—i.e., only instruments that may be included in calculating tier 1 capital adequacy for banks may be used in holding company capital adequacy calculations. For example, trust preferred debt securities would be excluded from tier 1 capital. **Sec. 171 (p. 62)**. Consider the following elements of the Collins Amendment:

i. The Collins Amendment requirements are to be applied without regard to total consolidated asset size or foreign financial exposure.

ii. Bank minimum standards as of the date of enactment are a floor for the requirements as applied to insured depository institutions, deposit institution holding companies, and Supervised NBFCs.

iii. This section is immediately effective for instruments issued after May 19, 2010 by depository institution holding companies and Supervised NBFCs. For debt or equity instruments issued before May 19, 2010, any regulatory capital deductions required by the section are to be phased in incrementally over three years beginning January 1, 2013.

iv. For "depository institution holding companies not previously supervised" by the Fed —savings and loan holding companies ("SLHCs")—the provision does not take effect until 5 years after enactment, except for the provisions that call for the three-year phase in of previously issued debt and equity instruments.

v. A holding company that had less than $15 billion in consolidated assets as of December 31, 2009 and any mutual holding company as of May 19, 2010 would not be required to implement the capital deductions applied to large companies.

vi. The Collins Amendment provisions do not apply to any instruments issued to the U.S. government under the Emergency Economic Stabilization Act of 2008, or to any Federal home loan bank, or any "small bank holding company" (defined as one with *pro forma* consolidated assets of less than $150 million). **Sec. 171 (pp. 62-65)**.

5. Studies and Reports on Holding Company Capital Requirements

a. Studies

Study of Hybrid Capital Instruments. The Comptroller General, in consultation with the Fed, the Comptroller of the Currency (the "Comptroller" or "OCC"), and the FDIC, are required to conduct a study of the use of hybrid capital instruments as a component of tier 1 capital for banking institutions and BHCS. The study must consider current use, difference between the components of capital permitted for insured depository institutions and for companies that control depositories, the benefits and risks of allowing such instruments to comply with tier 1 capital requirements, the economic impact of a prohibition, a review of the consequences of disqualifying trust preferred instruments, the international competitive implications of such a move, the impact on the cost and availability of credit in the United States, the availability of capital for financial institutions with less than $10 billion in total assets, and any other relevant factors. **Sec. 174(a) (pp. 67-68)**. A report on this study must be submitted to Congress within 18 months of enactment. **Sec. 174(c) (p. 68)**.

Study of Foreign Bank IHC Capital Requirements. The Comptroller General, in consultation with the Secretary, the Fed, the Comptroller, and the FDIC are to conduct a study of capital applicable to U.S. IHCs of foreign banks that are BHCs and SLHCs. **Sec. 174(a) (p. 68)**.

b. Well Capitalized/Well Managed Requirement

Title VI includes an additional provision that enhances the Gramm-Leach-Bliley requirements for BHCs and SLHCs engaged in "financial activities" by imposing a "well capitalized/well managed" requirement on such BHCs and SLHCs. **Sec. 606 (p. 236)**. Currently, only banks in a financial holding company are subject to the "well capitalized/well managed" requirement. "Financial activities" include merchant banking, investment banking, insurance and other activities "closely related to banking." "Well capitalized" for banks means 10% total risk based capital ratio and 6% tier 1 risk based capital ratio under Regulation Y.

G. Countercyclical Capital Requirement

Title VI grants the Fed express authority to adopt capital rules for all BHCs and SLHCs. **Sec. 616 (p. 245)**. Title VI also requires that the Fed seek to make all capital requirements countercyclical, so that the amount of capital required to be maintained by a company increases in times of economic expansion and decreases in times of economic contraction. **Sec. 616 (p. 245)**.

H. Intermediate Holding Companies and Activities of a Supervised NBFC

1. Role of the Fed in Establishing Intermediate Holding Companies

If a Supervised NBFC conducts activities that are not financial in nature (under Section 4(k) of the BHC Act), the Fed may require that the company establish an IHC in which it conducts "all or a portion" of its financial activities, not including internal financial activities. **Sec. 167(b)(1) (p. 59)**. The Fed must require a Supervised NBFC to establish an IHC if it deems this is necessary for the Fed to appropriately supervise the company's financial activities, or to ensure that supervision by the Fed does not extend to the activities of such company that are not financial in nature. **Sec. 167(b)(1)(B) (p. 59)**. Under these provisions, even though a Supervised NBFC would be at least 85% financial, it could be required to transfer some or all of its financial activities, other than "internal financial activities," to an IHC subsidiary.

2. Exception for Internal Financial Activities

A Supervised NPFC forming an IHC can continue to perform "internal" financial activities outside of the IHC structure, and can continue to perform these activities for some external parties. Activities that are required to be conducted in an IHC under this provision (because they are determined to be financial in nature or incidental thereto under Section 4(k) of the BHC Act) are not "internal financial activities," which include "internal treasury, investment, and employee benefit functions." **Sec. 167(b)(2) (p. 59)**. In addition, any "internal financial activity" that the company or an affiliate engaged in for itself and a non-affiliate during the year prior to enactment, the company (or affiliate that is not an IHC or a subsidiary if an IHC) can continue to engage in (outside of the IHC) as long as at least two-thirds of the assets or two-thirds of the revenues generated by the activity are attributable to the company or an affiliate (subject to the Fed's ability to review and determine that the activity presents an undue risk to the company or U.S. financial stability). **Sec. 167(b)(2) (p. 59)**.

3. Regulations

Note that the Fed must issue regulations establishing criteria for determining whether a Supervised NBFC must establish an IHC.

4. Affiliate Transaction Rules

The Fed may issue regulations to establish restrictions or limitations on transactions between an IHC and a Supervised NBFC as needed to prevent unsafe and unsound practices between a parent company and its affiliates. **Sec. 167(c) (p. 61)**. However, note that the Fed may not adopt affiliate transaction rules for IHCs that would "restrict or limit any transaction in connection with the *bona fide* acquisition or lease by an unaffiliated person of assets, goods, or services." **Sec. 167(c) (p. 61)**. These regulations—like all regulations to be issued by the Fed under Subtitles A and C of Title I—must be issued within 18 months of the effective date of the Act. **Sec. 168 (p. 61)**.

5. Source of Strength

A company that directly or indirectly controls such an IHC must serve as a source of strength to its subsidiary IHC. **Sec. 167(b)(4) (p. 60)**.

6. Reports

The parent of an IHC may be required to file reports, as the Fed determines, to allow assessment of compliance and ability to serve as a source of strength. The Act also states expressly that the parent company will be subject to the enforcement provisions of Section 8 of the FDI Act as if it were a BHC. **Sec. 167(b)(5) (p. 60)**.

7. Parallel to Title VI IHC Provisions

Note that the Title I IHC provisions closely parallel IHC provisions for certain grandfathered SLHCs under Title VI, which deals with the regulation of SLHCs and depository institutions. A grandfathered SLHC might also be a Supervised NBFC and thus subject to both sets of IHC provisions. House Financial Services Chairman Frank addressed this possibility in a floor colloquy at the time of final passage of this legislation by the House and stated that these provisions are intended to be applied "in harmony" so that affected firms will not be subject to inconsistent requirements.

I. Examination and Enforcement Actions for Insurance and Orderly Liquidation Purposes

Title I amends Section 10(b)(3) of the FDI Act to provide that, with regard to a Title I Company, whenever the FDIC determines that a special examination of any depository institution subsidiary for insurance purposes or of a Title I Company itself for the purpose of implementing its authority to provide for an orderly liquidation under Title II, the Fed can examine the company unless the company is "in generally sound condition." **Sec. 172(a) (p. 65)**. The Title also provides that before conducting such a special examination, the FDIC must review any available and acceptable resolution plan that the company has submitted and must coordinate with the Fed. **Sec. 172(a) (pp. 65-66)**.

J. Access to United States Financial Markets by Foreign Institutions

1. Foreign Banks

Title I amends Section 7(d)(3) of the International Banking Act to provide that a foreign bank that presents a risk to U.S. financial stability may only establish bank offices in the United States if the home country of the foreign bank has adopted, or is making demonstrable progress toward adopting, "an appropriate system of financial regulation for the financial system of such home country to mitigate such risk." **Sec. 173(a) (p. 66)**. Moreover, foreign bank offices in the United States may be terminated if a foreign bank that represents risk to U.S. financial stability if its home country has not adopted or made progress in adopting such an appropriate system of financial regulation. **Sec. 173(b) (p. 67)**.

2. Foreign Brokers or Dealers

Title I amends Section 15 of the Securities Exchange Act of 1934 (the "Exchange Act") to provide that the SEC, in determining whether to permit a foreign person to register in the United States as a broker dealer (or succeed to the registration of a U.S. broker or dealer), may consider whether, for a person that presents a risk to U.S. financial stability, the home country of the person has adopted, or made demonstrable progress toward adopting, an appropriate system of financial regulation to mitigate such risk. The SEC may terminate the registration of such a person if such progress in the home country has not been made. **Sec. 173(c) (p. 67)**.

K. Study on the Effects of Size and Complexity of Financial Institutions on Capital Market Efficiency and Economic Growth

The Chairperson of the Council is required to carry out a study and issue a report to Congress within 180 days of enactment and every 5 years thereafter of the economic impact of possible financial services regulatory limitations intended to reduce systemic risk. The study must estimate the benefits and costs on the efficiency of capital markets, the financial sector, and national economic growth of:

i. Limits on the maximum size of banks, BHCs, and other large financial institutions;

ii. Limits on the organizational complexity and diversification of large financial institutions;

iii. Requirements for operational separation between business units of large financial institutions in order to expedite resolution in case of failure;

iv. Limits on risk transfer between business units of large financial institutions;

v. Requirements to carry contingent capital or similar mechanisms;

vi. Limits on commingling of commercial and financial activities by large financial institutions;

vii. Segregation requirements between traditional financial activities and trading or other high-risk operations in large financial institutions; and

viii. Other limitations on the activities or structure of large financial institutions that may be useful to limit systemic risk. **Sec. 123 (p. 38)**.

L. Office of Financial Research

1. Functions of the Office

Subtitle B of Title I relates to the formation and function of the Office. The purpose of the Office, which has rulemaking authority to support its functions, is to support the Council in fulfilling its duties, including by:

i. Collecting data on behalf of the Council, and providing such data to the Council and member agencies;

ii. Standardizing the types and formats of data reported and collected;

iii. Performing applied research and essential long-term research;

iv. Developing tools for risk measurement and monitoring;

v. Performing other related services;

vi. Making the results of the activities of the Office available to financial regulatory agencies; and

vii. Assisting such member agencies in determining the types and formats of data authorized by this Act to be collected by such member agencies. **Sec. 153(a) (p. 41)**.

2. Director of the Office

The provisions call for the Director of the Office to be appointed by the President with the advice and consent of the Senate and serve for a term of 6 years. **Sec. 152(b) (p. 39)**. The Director and other Office employees with access to data maintained in the Data Center are to be prohibited from working or consulting for a financial company for one year following having had access to such data. **Sec. 152(g) (p. 40)**.

3. Data Center

The Data Center is one of the two major structures within the Office. Its function is to collect, validate and maintain data obtained from member agencies, commercial data providers, and public sources. The Office has authority (which must be determined by the Council or by the Director in consultation with the Council) to require the submission of reports from any financial company for the purpose of assessing the extent to which a financial activity or financial market in which the company participates poses a threat to U.S. financial stability. **Sec. 154(b) (p. 43)**. Note that for these purposes, the term "financial company" has the same meaning as in Title II and includes an insured depository institution and an insurance company. **Sec. 151(1) (p. 39)**. The Office is to promulgate regulations regarding the type and scope of data to be collected by the Data Center. **Sec. 154(b)(1)(C) (p. 43)**. While the Data Center is to publish a financial company reference database, a financial instrument reference database and the standards for reporting data to the Office, it is also required not to publish confidential data and the Director is to ensure that any data collected is secure and protected from unauthorized disclosure. **Sec. 154(b)(2) and (3) (p. 43).**

4. Research and Analysis Center

The Research and Analysis Center—the other major structure within the Office—is required to develop and maintain independent analytical capabilities and computing resources needed to do the following:

i. Develop and maintain metrics and reporting systems for risks to the financial stability of the United States;

ii. Monitor, investigate, and report on changes in system-wide risk levels and patterns to the Council and Congress;

iii. Conduct, coordinate, and sponsor research to support and improve regulation of financial entities and markets;

iv. Evaluate and report on stress tests or other stability-related evaluations of financial entities overseen by the member agencies;

v. Maintain expertise in such areas as may be necessary to support specific requests for advice and assistance from financial regulators;

vi. Investigate disruptions and failures in the financial markets, report findings, and make recommendations to the Council based on those findings;

vii. Conduct studies and provide advice on the impact policies related to systemic risk; and

viii. Promote best practices for financial risk management. **Sec. 154(c) (p. 44)**.

5. Reporting Responsibilities

The Office is to submit a report to Congress assessing the state of the U.S. financial system (including any threats to financial stability and the status of the Office's efforts to meet its mission) within 2 years of enactment and within 120 days of the end of each succeeding fiscal year. **Sec. 154(d) (p. 44)**.

6. Paying for the Office

Title I Companies will be charged an assessment that will cover the total expenses of operating the Office. The assessment base and rates will be established by the Secretary with the approval of the Council and will take into account differences among the assessed companies. **Sec. 155(d) (p. 45)**. These assessments will begin two years after enactment, with funding during the first two years provided by the Fed. **Sec. 155(c) (p. 45)**.

TITLE II: Orderly Liquidation Authority

A. Overview: Orderly Liquidation Authority

Title II of the Act creates a non-Bankruptcy Code framework for providing both financial assistance to help failing and failed BHCs and operational assistance in managing the liquidation of such large, systemically connected companies (the "Orderly Liquidation Authority" or "Liquidation Authority"). The purpose of the Orderly Liquidation Authority is to "provide the necessary authority to liquidate failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard." **Sec. 204(a) (p. 81)**. The Act empowers the Treasury to appoint the FDIC as receiver to liquidate a covered financial company (a "CFC"), with broad discretion and power to manage such company and minimize the liquidation's impact on the U.S. economy.

The new liquidation authority supplants the Bankruptcy Code (the "Code") as the statutory regime for the failure of large, systemically significant financial companies. Most financial companies will operate under the Code. However, if the collapse of a financial company could threaten the U.S. economy, such company will be placed into the new regulatory regime.

If the legislation creates significant new uncertainties among market participants, the terms, pricing, and valuation of past and future transactions could potentially be affected. A 2009 Fed staff memorandum correctly notes that the "resolution regime directly and significantly affects preexisting contractual and property rights. While this regime must be outside the Code in order to allow the resolving agency to be responsive to the circumstances of the specific financial crisis that motivated use of the regime, it must still operate in a manner that respects the rule of law *and that is perceived as such*."

Because both the Code and the Act could apply to the same company, differences between the Code and the Act are noted below and such *differences are noted in italics.*

B. Application of Orderly Liquidation Regime to Covered Financial Companies

The Act's liquidation regime applies to a "financial company," as defined by Section 201(a)(11), which includes a company incorporated or organized under federal or any state law that is:

i. A BHC;

ii. A NBFC supervised by the Fed;

iii. A company that is predominantly engaged in activities that the Fed has determined are financial in nature or incidental thereto for purposes of Section 4(k) of the BHC Act; or

iv. Any subsidiary of the above that is predominantly engaged in activities that the Fed has determined are financial in nature or

> incidental thereto for purposes of the BHC Act Section 4(k), other than a subsidiary that is an insured depository institution or insurance company; and

that is not a Farm Credit System institution, a government entity or regulated entity, as defined under Section 1303(20) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992. **Sec. 201(a)(11) (p. 70)**. For a company to be classified as a financial company due to its activities that the Fed has determined are financial in nature or incidental thereto, 85% or more of the company's revenue must come from such activities. **Sec. 201(b) (p. 71)**. The FDIC may appoint itself as receiver for any subsidiary (other than an insured depository institution, a covered broker or dealer (a "CBD") or an insurance company) of a CFC if the FDIC and Secretary jointly determine that the subsidiary is in default or in danger of default, appointing the FDIC as receiver of the subsidiary would mitigate the negative effects on the U.S. economy and such action would facilitate the orderly liquidation of the CFC. **Sec. 210(a)(1)(E) (p. 88)**.

While the Act excludes subsidiaries of a financial company that are insurance companies from the definition of "financial company," insurance holding companies are not excluded and could fall within the purview of the Act. Insurance companies are resolved under state law, but the FDIC could stand in the place of a state regulatory agency for the resolution of such insurance company under state law if the regulatory agency fails to file for judicial action within 60 days of the FDIC's appointment as receiver. **Sec. 203(e) (p. 81)**.

Under the Code, an eligible entity may file a voluntary petition for relief under the auspice of the Code. Although solvent companies can be debtors under the Code, generally only insolvent debtors seek protection, and the Bankruptcy Court, on a proper showing, may dismiss a bad faith filing. Three or more entities holding undisputed, noncontingent, liquidated unsecured claims (each in excess of a minimal dollar amount) against a company may file an involuntary petition requesting entry of an order for relief under the Code against such company. A company that is the subject of an involuntary petition may oppose the entry of an order for relief under the Code. (See below for further details on involuntary petitions.)

C. Initiation of Orderly Liquidation Authority

Under the Act, initiation of the liquidation regime begins when the FDIC and the Fed makes a recommendation as to whether the Secretary should appoint the FDIC as receiver for a financial company. The recommendation is required to include a number of items, including an evaluation of whether a CFC is in default or danger of default and a description of the effect that default would have on the financial stability of the United States. The Fed and the SEC make the recommendation if the company or its largest subsidiary is a broker or dealer; the Fed and the FIO would make the recommendation if the company or its largest subsidiary is an insurance company. The Secretary then determines, based on the written recommendation and after consultation with the President, whether (a) the financial company is in default or danger of default; (b) the failure of the financial company would have serious negative effects on U.S. financial stability; (c) private sector alternatives would not prevent the default of the CFC; (d) any effect on the claims and interests of creditors, counterparties and shareholders of the financial company and other market participants would be appropriate given the impact of such actions on the U.S. economy; (e) actions under the Act would avoid or mitigate such adverse effects; (f) a federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments; and (g) the company is a "financial company" under Section 201. **Sec. 203(a)-(b) (pp. 77-78)**.

If the above standards are met, the Secretary then petitions the Court for an order authorizing the Secretary to appoint the FDIC as receiver of the financial company if the board of directors of the CFC does not acquiesce or consent to the FDIC's appointment as receiver of the CFC; if the board consents to the appointment, the Secretary appoints the FDIC as receiver without petitioning the Court. If the Court finds the Secretary's determination is not "arbitrary and capricious" in this hearing, in which the CFC may contest the Secretary's findings, the Court would then issue an order immediately authorizing the Secretary to appoint the FDIC as receiver for the CFC and to commence the resolution process. If the Secretary's determination is "arbitrary and capricious," the Court immediately provides the Secretary with a written statement of the reasons behind its determination and provides the Secretary with an immediate opportunity to amend and refile the petition. If the Court does not make a determination on the petition within 24 hours of its filing, the petition is granted by operation of law and the liquidation of the CFC would commence. Once the order is granted, the FDIC, as receiver, resolves the CFC under Title II of the Orderly Liquidation Authority. **Sec. 202(a)-(b) (pp. 71-74)**. If the CFC is a CBD, then the Securities Investor Protection Corporation (the "SIPC") is also appointed as the trustee and special liquidation rules would apply. **Sec. 205(a) (pp. 82-83)**.

In contrast, there is no procedure for a non-creditor, including the Treasury Department, the Fed, or the FDIC, to commence a case under the Code against a company. A voluntary bankruptcy petition may be filed by any eligible debtor. Involuntary petitions may be filed by three or more creditors who hold unsecured, non-contingent, undisputed claims which aggregate to at least $13,475. Involuntary petitions may be contested by the debtor/company. An involuntary petition will be granted, and an order for relief entered, if the Bankruptcy Court finds that the company is not paying its debts as they come due. If a company has fewer than 12 such creditors, a single creditor holding at least $13,475 in unsecured, non-contingent, undisputed claims may file the involuntary petition.

D. Powers of the Receiver Over the CFC

Upon initiation of the liquidation proceedings, the Act gives the FDIC as receiver significant power over a CFC. The FDIC, as receiver, can:

i. Take over the assets of and operate the CFC;

ii. Collect all obligations and money due to the CFC;

iii. Perform all functions of the CFC in the company's name;

iv. Manage the assets and property of the CFC;

v. Provide by contract for assistance in fulfilling any function, activity, action, or duty of the receiver;

vi. Merge the CFC with another company;

vii. Provide for the exercise of any function by any member or stockholder, director, or officer of the CFC;

viii. Organize a bridge financial company (a "Bridge Company"); or

ix. Transfer any asset or liability of the CFC without any approval, assignment or consent with respect to such transfer. **Sec. 210(a)(1)(B)-(G) (pp. 87-89)**.

Unlike the FDI Act, there are no provisions in the Act that require the receiver to seek the least costly resolution in the liquidation of an insured depository institution.

In a chapter 11 case (reorganization) under the Code, the debtor continues to be managed and operated by the old board and management of the company, which is entitled to propose a plan for the reorganization or liquidation of the company. When management and the old board continue in this capacity, the debtor is known as the debtor-in-possession (the "DIP"). Upon the occurrence of certain events, the DIP may be displaced and a chapter 11 trustee may be appointed to manage and operate the business of the company. By contrast, in a chapter 7 case (liquidation), a trustee is appointed when the case is initially commenced and that trustee administers the liquidation of the assets of the company. In either case, the DIP or trustee is the successor in interest to the rights, titles, assets, and affairs of the debtor.

In a chapter 11 case, the DIP or trustee is authorized to operate the business of the debtor and take actions in the ordinary course of business, without court approval. Transactions or actions "outside the ordinary course of business," such as post-petition loans and the sale of significant operating assets, require the approval of the Bankruptcy Court. By contrast, a chapter 7 trustee has more limited operating authority. In general, the court reviews out-of-the-ordinary-course transactions to determine if they are in the best interests of the estate. Actions outside the ordinary course of business include, without limitation:

i. Paying pre-petition debts;

ii. Paying professionals and advisors without a Bankruptcy Court order;

iii. Selling assets outside the ordinary course of business;

iv. Using cash collateral without the consent of secured creditors or the Bankruptcy Court; and

v. Obtaining credit or incurring secured or unsecured debt without Court approval.

E. Orderly Liquidation Fund

The FDIC, as receiver, has the authority to provide financial assistance to the CFC from a newly established Orderly Liquidation Fund (the "Fund"). **Sec. 204(d) (p. 82)**. The Fund is capitalized only after the FDIC is appointed as receiver of a CFC through FDIC-issued debt securities sold to the Treasury. For the first 30 days after the CFC's appointment as receiver, the FDIC is able to issue obligations of an amount equal to 10 percent of the total consolidated assets of the CFC. After 30 days, the FDIC can issue obligations for an amount that is equal to 90 percent of the fair value of the total consolidated assets of each CFC that are available for repayment. The FDIC can issue the latter amount sooner than 30 days if it can calculate the total consolidated assets of each CFC before the 30-day period after its appointment.

Under the Act, the FDIC recoups its expenditures from the Fund from proceeds received through the liquidation process and assessments on claimants and financial companies. Expenditures from the Fund have super-priority status among claims of its applicable priority level. Assessments for the Fund are placed initially on any claimant that received additional payments due to the FDIC's preferential treatment of such claimant in the liquidation process—except for payments or amounts necessary to initiate or continue operations essential to the receivership or any bridge company; such preferential treatment is allowed under the Act if necessary to minimize losses in the liquidation of the CFC. These assessments equal the amount the claimant received from the FDIC minus the amount the claimant was entitled to recover solely from the liquidation of the CFC under Title II (or the amount the claimant would have received from a chapter 7 liquidation under the Code). If assessments on unequally treated claimants and proceeds from the liquidation process are insufficient to recoup the Fund's expenditures, the FDIC must issue risk-based assessments on BHCs and financial companies with over $50,000,000,000 in consolidated assets and NBFCs supervised by the Fed. **Sec. 210(n)-(o) (pp. 134-140)**.

To impose assessments, the FDIC requires financial companies to make information available to it to enable it to determine the scope of risk-based assessments. The size of an assessment is based on a risk matrix in which the FDIC must take into account the economic conditions generally affecting financial companies, other assessments imposed on the company, the extent the financial company has benefitted from the orderly liquidation and use of the Fund under the Act, the risks presented by the financial company to the U.S. financial stability, any risks presented by the company in the previous 10 years that contributed to the failure of the CFC and other factors the FDIC or the Council deem appropriate. Assessments are imposed on a graduated basis, with financial companies having greater assets assessed at a higher rate. The FDIC is required, in consultation with the Secretary, to impose rules and regulations to administer assessments. **Sec. 210(n)-(o) (pp. 134-140)**. The Act prohibits the use of taxpayer funds to prevent the liquidation of the CFC. **Sec. 214 (p. 146)**.

The Code does not provide for any government funding for companies undergoing the liquidation or reorganization process.

F. Judicial Review By Article III Courts

1. Judicial Review Generally

The Act limits the role of courts during the resolution process. In general, "no court may take any action to restrain or affect the exercise of powers or functions of the receiver," unless specifically provided in the Act. Any remedy against the FDIC is limited to money damages determined in accordance with the Act. **Sec. 210(e) (p. 123)**.

Under the Code, all aspects of a case are subject to judicial review from the onset of a bankruptcy proceeding. The Bankruptcy Court must affirmatively grant prior approval of non-ordinary courses of action by the DIP or the trustee. In addition, creditors can seek relief from the Bankruptcy Court related to various other matters. Bankruptcy Court rulings are subject to appeal to the District Court and, thereafter, to the Circuit Court.

2. Judicial Review of the Initiation of the Liquidation Authority and Appointment of Receiver

As discussed above, the Act provides for judicial review of the Secretary's determination to commence the Orderly Liquidation Authority. The Secretary is required to petition the Court to appoint the FDIC as receiver if the CFC does not acquiesce to the FDIC's appointment. The Court evaluates the Secretary's determinations under an arbitrary and capricious standard; if the Secretary's determination is not arbitrary and capricious then the Court issues an order for the appointment of the FDIC as receiver. The Court is required to make its decision within 24 hours of receipt of the petition; if no decision is made within 24 hours, the FDIC's appointment is automatically granted.

The Act also provides judicial review of the Court's decision to grant an order for the appointment of the FDIC as receiver. The CFC or the Secretary can file, no later than 30 days after the decision of the Court, an appeal of the Court's decision to the U.S. Court of Appeals for the District of Columbia Circuit. A petition for *writ of certiorari* to review a decision by the D.C. Circuit could be filed with the Supreme Court no later than 30 days after the date of the final decision of the Court of Appeals. Review of the Court's determinations by the D.C. Circuit and the Supreme Court would be limited to whether the Secretary's determination that the CFC is in default or in danger of default and the CFC is a financial company is arbitrary and capricious. **Sec. 202 (pp. 71-76)**.

There is no Code analogue to this provision.

3. Judicial Review of Claim Determinations

The Act allows a claimant to contest a claim determination by the FDIC in the district court for the district where the principal place of business of the CFC is located. Such claim would need to be brought to the district court within 60 days of the FDIC's allowance or disallowance of the claim. **Sec. 210(a)(4) (pp. 93-94)**.

The Code, and its accompanying rules, establishes court-supervised procedures for the filing and resolution of disputes relative to claims. Unlike district court under the Act, the Bankruptcy Court is very involved in the claims process.

G. The Claims Process

At the heart of the dissolution authority is the resolution of creditors' claims against the CFC. All parties with claims against the CFC are required to present their claims to the FDIC. As the receiver, the FDIC has the power to determine all claims against the CFC and can disallow a claim, in part or in whole, which it determines has not been proved to its satisfaction. The FDIC is required to make such determination within 180 days from the date such claim is presented, although such time may be extended by agreement with the claimant. **Sec. 210(a)(2)-(3) (pp. 91-93)**.

The proposed claims process under the Act differs significantly from the one provided under the Code. The DIP or trustee does not make the initial determination on claims, leaving creditors to file litigation challenging such determination. Under the Code, the debtor files schedules indicating to whom and how much it believes it owes. If a creditor agrees with the amount for which it is scheduled, it needs to take no action and will be granted an allowed claim. If a creditor disagrees with the scheduled amount or desires to make an additional claim, it may, within a set bar date, file a proof of claim reflecting the amounts that the creditor believes it is owed. In the absence of an objection from the debtor, a creditor's claim is allowed in the amount of the proof of claim filed by the creditor. If the debtor disputes any proof of claim, it has the affirmative burden to file a claims objection with the Bankruptcy Court. The creditor may respond to the claims objection and the Bankruptcy Court would resolve these claim disputes. The decisions of the Bankruptcy Court are subject to appeal.

1. Secured Claims

The Act generally protects security interests granted to secured creditors where the CFC holds the assets or property that is subject to such security interests, and it provides that such secured creditors <u>must</u> be secured up to the fair market value of their collateral. As such, a secured creditor has the first claim to the fair market value of the assets that secure such creditor's claim. The FDIC treats the portion of any claim that exceeds the fair market value of such collateral as an unsecured claim and does not make payment with respect to such unsecured portion other than in connection with a disposition of all unsecured claims.

The FDIC's maximum liability for the deficiency claim of a secured creditor is limited to what such creditor would have been entitled to receive if the CFC had been liquidated under chapter 7 of the Code and the Orderly Liquidation Authority was not commenced. This amount is determined by the FDIC. The Act contains no express provision as to the point in time at which such fair market value is measured. Thus, there may be disagreement about the appropriate measurement date for the fair market value of the collateral and even whether fair market value is evaluated assuming initiation or absence of the Orderly Liquidation Authority on another CFC.

Under the Act, the FDIC cannot reject any legally enforceable or perfected security interest in the assets of the CFC unless such interest was a fraudulent or preferential transfer. The FDIC cannot disallow any portion of a legally enforceable or perfected security interest securing an extension of credit from any Federal Reserve Bank or the Secretary. **Sec. 210 (a)(3)(D), 210(c)(12), and 210(d) (pp. 93, 120, and 122-123)**.

The FDIC can prime a secured creditor's collateral position under the Act in order to obtain credit for a Bridge Company. However, in doing so the FDIC is required to provide such creditor with adequate protection, and the FDIC has the burden of proof on whether adequate protection has been provided. **Sec. 210(h)(16) (pp. 131-132)**. The title precludes avoidance of any legally enforceable and perfected interests in customer property. **Sec. 205(d) (p. 84)**.

Under the Code, secured creditors are secured up to the value of the collateral. The value of the collateral is determined in light of the purpose of the valuation. Unlike the Act, under the Code there is a deep and developed body of case law precedent as to how collateral is valued under different circumstances. A secured party's collateral can be used if there is a demonstration of adequate protection of the interest of such party. The Code also contains statutory parameters for "adequate protection" and a deep and developed body of case law precedent as to what constitutes adequate protection under different circumstances.

a. Unsecured Claims

The Act creates a priority structure for unsecured claims similar to that in the FDI Act. Unsecured claims have the following priority, in descending order:

i. Administrative expenses of the receiver;

ii. Any amounts owed to the United States;

iii. Wages, salaries, or commissions earned not later than 180 days before the date of appointment of the FDIC as receiver ($11,725 per individual);

iv. Contributions owed to employee benefit plans arising from services rendered not later than 180 days before the date of appointment of the FDIC as receiver ($11,725 per individual);

v. General or senior liabilities of the CFC;

vi. Obligations subordinated to general creditors;

vii. Any wages, salaries or commissions owed to senior executives and directors of the CFC;

viii. Obligations to persons with interests in the equity of the CFC as a result of their status as a shareholder, member, etc. **Sec. 210(b)(1) (p. 103)**.

As discussed above, the Act gives priority to claims of the United States against the CFC over other unsecured creditors. In addition, any amount owed to the FDIC from expenditures from the Fund will be given super-priority status among all creditors at the expenditure's appropriate priority level. **Sec. 204(d) (p. 82)**. Similarly situated creditors for each type of unsecured claim will be treated similarly unless the FDIC determines that dissimilar treatment is necessary to maximize the value of the CFC's assets, initiate and continue operations essential to the CFC or a Bridge Company, maximize the present value return from the sale of assets, or minimize losses to the CFC's assets. **Sec. 210(b) (pp. 103-105)**. The Act allows any obligation "necessary and appropriate" for the smooth resolution of the CFC to qualify as an administrative expense, which is given the highest priority level among unsecured creditors. **Sec. 201(a)(1) (p. 69)**. All similarly situated creditors receive not less than the amount they would receive under a chapter 7 liquidation (as discussed below). **Sec. 210(d)(2) (p. 122)**.

There are significant differences in the treatment of unsecured claims under the Act and the Code. The first significant difference relates to the guidance provided in each statute as to what is an allowable claim. The Code has numerous provisions that provide parameters for what claims will be allowed and, in some instances, limitations on the amounts for which such claims will be allowed. A deep body of precedent provides further guidance on these parameters. No similar provisions or precedent exist relative to the Act. The Code's guidance on claims lends more certainty and transparency to the Code's procedures than to those under the Act.

The second major difference is that the Code, unlike the Act, does not permit similarly situated creditors to be treated dissimilarly. While some court-enacted doctrines enable a debtor to pay pre-petition creditors when it is necessary for the successful continuation of the debtor's business, these payments are authorized only when the Bankruptcy Court determines that such payment will enhance or preserve the value of the debtor's business which will inure to the benefit of all creditors; thus, there is no concept of cherry-picking the payment of one creditor to achieve a goal, such as a systemic resolution goal, that is not in the best interests of all creditors.

Finally, although the distributional priorities under the Act and the Code differ, both require administrative expenses to be paid in full before unsecured claims are paid. However, under the Act, any debt owed to the U.S. government or to the Fund must also be repaid in full before unsecured claims are paid. In contrast, the Code pays <u>certain</u> employee, tax, and other claims before unsecured claims, but does not require <u>all</u> obligations to the U.S. government to be paid in full before any other creditors are paid. For example, if the United States had entered into a contract with a debtor and that contract was rejected, under the Code, the damages claim owed to the United States would be treated like any other general unsecured claim; under the Act that claim would be paid before general unsecured claims.

2. Valuation of Claims

The Act establishes that the maximum liability to any person having a claim against the FDIC (acting as receiver for a CFC) will be the amount such claimant would have received if the FDIC had not been appointed receiver and the CFC had been liquidated under chapter 7 of the Code (or under a similar provision of State insolvency law). The Act does not identify the methodology used to value the collateral, nor does it provide any other rights for creditors to fully participate in the process, including disputes over the amount a creditor would receive from the liquidation of the assets. The FDIC can make additional payments to a claimant if the FDIC determines that such actions would minimize losses to the FDIC as receiver. **Sec. 210(d)(2) (p. 122)**.

The Act contains special provisions for the valuation of customer claims in the resolution of a CBD. The Act resolves all customer claims of CBDs in the same manner and for the same amount as the Securities Investor Protection Act (the "SIPA"). Any obligation of a CBD to a customer relating to customer property would be paid in an amount that is at least as beneficial to the customer as if the CBD had been subject to a proceeding under the SIPA or by delivering the securities to the customer. **Sec. 205(f), 210(d)(2) (pp. 85, 122)**.

By contrast, the Code is meaningfully different in two key respects. First, a claimant's *recovery under chapter 11 (reorganization) of the Code is not limited to such claimant's chapter 7 liquidation recovery and, indeed, chapter 11 reorganizations generally yield reorganization value that results in increased recoveries to creditors above the chapter 7 liquidation recovery amount. Second, the Code leaves to the determination of the Bankruptcy Court whether a creditor is actually receiving what they are entitled to receive under the Code; by contrast, under the Act, there is no mechanism for court review of the determination of the FDIC as to how much a claimant with an allowed claim is entitled to be paid.*

H. Contracts

The Act grants the FDIC the power to repudiate "burdensome" contracts and leases of the CFC, within a reasonable time, if it determines such repudiation will promote the orderly administration of the CFC. The FDIC's ability to repudiate any contract because it is "burdensome" does not apply to any extension of credit from the Fed or the FDIC to the CFC, or to any security interest in the assets of the CFC securing such extension of credit. The receiver will be liable only for "actual direct compensatory damages" measured "as of" the date the receiver is appointed; recoveries for profits, lost opportunity, pain and suffering, and punitive damages are not allowed.

The FDIC can enforce any contract (other than a financial institution bond or a director and officer insurance contract) and require performance by the counterparty of its contractual obligations despite termination rights due to the insolvency or financial condition of the company (*ipso facto* provisions). Further, for the first 90 days of a receivership, the other party to a contract with a CFC will not be able to exercise any right to terminate, accelerate, or declare a default to the contract or obtain possession or control over any property of the CFC without the FDIC's consent; such "hold" does not apply to director or officer liability insurance contracts, financial institution bonds, the rights of parties to certain qualified financial contracts ("QFCs") or certain contracts under the FDIC Improvement Act. The FDIC, however, cannot reinstate a contract that was terminated before the appointment of the FDIC. **Sec. 210(c) (pp. 105-122)**.

The Act also adopts a less stringent version of the *D'Oench Duhme* doctrine, codified in the FDI Act, to contracts against the interest of the FDIC. Under the Act, any agreement that tends to diminish or defeat the interest of the FDIC as receiver in any asset acquired by the FDIC is not valid unless the agreement (a) is in writing, (b) was executed by an authorized officer or representative of or confirmed in the ordinary course of business by the CFC, and (c) has been an official record of the CFC since the time of its execution or the party claiming under the agreement provides documentation of such agreement and its authorized execution by the CFC. **Sec. 210(a)(6) (p. 95)**.

Under the Code, if a contract is rejected, it will give rise to a pre-petition unsecured claim for damages, which may be paid *pro rata* rather than in full. Rejection of claims for some types of contracts, such as long-term leases and employment contracts, are limited in terms of the amount that will be allowed. Executory contracts first assumed by a debtor but subsequently rejected give rise to an administrative claim for a portion of the damages. The Code does not mirror the *D'Oench Duhme* doctrine's contract requirements, and contracts not in writing or authorized by an officer of the CFC may be enforceable. Unlike the Act, the Code prevents the assignment of certain types of contracts, including contracts where applicable law excuses a party from accepting performance from or rendering performance to a debtor and contracts for financial accommodations, without consent of the non-debtor party. Similarly, the Code has specific provisions to ensure that, prior to assuming and assigning contracts, the debtor must cure all defaults, compensate for damages, and provide adequate assurance of future performance. No such protections exist under the Act.

1. Qualified Financial Contracts

The Act has special rules for QFCs, which are securities contracts, commodities contracts, forward contracts, repurchase agreements, swap agreements, or other similar agreements that the FDIC determines by regulation, resolution, or order to be a QFC. When the FDIC is appointed as a company's receiver, counterparties to QFCs are prohibited from exercising their contractual rights to terminate, accelerate, set off, and net or enforce their security interests in collateral, where such rights are solely by reason of or incidental to the appointment of the FDIC as receiver or the insolvency or financial condition of the CFC, until 5:00 p.m. on the next business day following the date of the appointment. This period is intended to give the FDIC time to choose whether to transfer all or none of the QFCs, claims and property of any counterparty and its affiliates to another financial institution, including a Bridge Company. If the FDIC chooses to transfer a counterparty's QFCs, then the counterparty cannot terminate, accelerate, set off, and net or enforce their security interests in collateral due to the appointment of the FDIC as receiver or the insolvency or financial condition of the CFC. However, all QFCs, claims, and property securing the QFC or other credit enhancement between any counterparty or affiliate and the CFC would be transferred to a single financial institution; the FDIC cannot selectively pick and choose which QFCs made to a single counterparty are transferred. QFC counterparties can terminate for other defaults, such as non-payment or non-performance under the QFCs.

If the waiting period elapses and the FDIC does not elect to transfer the QFCs to another financial institution, counterparties can then exercise their rights to terminate, liquidate, or accelerate the contract, exercise any rights under a related security agreement, or exercise their rights to set off or net amounts due in connection with such QFCs. However, "walk-away" clauses, or clauses that suspend conditions or extinguish a payment obligation of a party due to the party's status as a non-defaulting party, are not enforceable under the Act.

Under the Act, the FDIC cannot avoid a transfer of money or property in connection with any QFC unless the transferee had actual intent to hinder, delay, or defraud the CFC, creditors, or receiver of the CFC. The Act allows preference and fraudulent conveyance challenges to QFCs, as well as challenges for set-off rights. Damages for repudiated QFCs include normal and reasonable costs of cover or other reasonable measure of damages used in the industry. **Sec. 210(c)(8)-(11) (pp. 108-119)**.

The Code provides "safe harbors" for QFCs and QFC counterparties. Non-debtor counterparties may, immediately and without seeking relief from the automatic stay, exercise their contractual rights under QFCs to (i) terminate or accelerate the obligations of the parties and liquidate and realize against any collateral held to secure the debtor's obligations and (ii) set off mutual debts and claims. These rights would typically be restricted under the Code in order to protect the estate of the debtor. In addition, any deliveries or settlements made *pursuant to these QFCs are protected from being avoided as either preferential or fraudulent transfers, provided that they were not made with an intent to defraud.*

I. Bridge Financial Companies

The Act allows the FDIC to organize one or more "Bridge Companies" and transfer any of the CFC's assets and liabilities to those Bridge Companies. The purpose of such transfer is to help the Bridge Companies maximize the net asset value of the transferred assets and liabilities and to separate the good assets and liabilities from the bad. The remaining company left behind is liquidated. This approach is mirrored after the FDI Act's "good bank-bad bank" approach, in which a bridge bank is used to protect depositors and provide significant business continuity for the "good" portion of the failed bank, leaving the FDIC receivership as the legal vehicle for sorting contractual and counterparty relationships with parties other than depositors, with the goal of maximizing amounts that can be paid to claimants. The Act provides that the aggregate amount of liabilities of a CFC that are transferred to a Bridge Company could not exceed the aggregate amount of assets of the CFC that are transferred to, or purchased by, the Bridge Company.

Under the Act, Bridge Companies are created with a federal charter with a board of directors appointed by the FDIC. Bridge Companies partly or fully assume the assets, rights, liabilities, powers, authorities, and privileges of the CFC. A transfer of a CFC's assets or liabilities does not require the consent of the counterparties. Contracts that are not assignable without consent under applicable agreement or laws are not exempt from transfer. Bridge Companies can obtain unsecured credit and issue unsecured debt. If a Bridge Company is unable to obtain unsecured credit or issue unsecured debt, the FDIC can authorize it to obtain secured credit or issue debt with priority over any or all of the other obligations of the Bridge Company, secured by a lien on property that is not otherwise subject to a lien or secured by a junior lien.

The Act requires the FDIC to treat all similarly situated creditors of the CFC equally when transferring the assets or liabilities of the company to a Bridge Company, unless unequal treatment is necessary to maximize the value of assets, maximize the present value of return from the sale of assets, or minimize the amount of any loss from the sale of assets. All such similarly situated creditors receive at least the Liquidation Amount. The Act may create uncertainty for creditors because the FDIC may transfer their claims or the assets securing their claims to a Bridge Company for less than fair value or, in the case of a secured creditor, without adequate protection of such creditor's secured claim. The Act does not provide any methodologies or judicial review for valuing claims or collateral securing such claims or any process to contest the values assigned by the FDIC. **Sec. 210(h) (pp. 123-132)**.

The Code does not contain the concept of a Bridge Company to hold assets. However, often a plan of reorganization will distribute certain assets to a liquidating trust, which will liquidate those assets and distribute them as provided in the plan. Generally, a liquidating trust holds primarily non-operating assets and litigation claims and not the operating assets of a business.

J. Fraudulent Transfers

The Act allows the FDIC to void a transfer of any interest of the CFC in property or obligation that is a fraudulent transfer. A transfer is to be deemed fraudulent if it was made (a) within two years before the appointment of the FDIC as the receiver; (b) with the actual intent to hinder, delay, or defraud the CFC or FDIC or the CFC received less than reasonably equivalent value in exchange; and (c) when the CFC was insolvent or became insolvent as a result of the transfer, the CFC was engaged in a transaction that would have resulted in an unreasonably small amount of capital remaining with the CFC, the CFC intended to incur debts that would leave the CFC with an inability to pay its debts when they became due, or such transfer was made to or for the benefit of an insider.

The FDIC can recover the property transferred or value of the property from the initial transferee or from any immediate or mediate transferee. The FDIC cannot recover from any initial transferee that takes for value, without knowledge of the transfer's potential voidability or any immediate or mediate good faith transferee of such initial transferee.

The Act allows a transferee the defenses provided under Sections 546(b) and (c), 547(c) and 548(c) of the Code. Transfers exempt from avoidance from these defenses include those made with certain perfected security interests, made in the reclamation of goods by a seller, that are contemporaneous exchanges for new value and with transferees that take the transfer for value and in good faith. The transferee also has the same defenses available to such transferee in an action brought under Sections 547, 548 and 549 of the Code. As such, Section 546(e), which protects settlement payments from avoidance and is a defense to an action under Sections 547, 548 and 549, appears to have been incorporated as a defense as well. **Sec. 210(a)(11) (pp. 98-100)**.

The DIP/trustee may avoid any transfer of an interest of the debtor in property, or any obligation by the debtor, made or incurred on or within two years before the date of the filing of the petition, if (a) made with the intent to hinder or defraud a creditor (actual fraud) or (b) in exchange for the transfer, the debtor received less than "reasonably equivalent value," and the debtor was unable to pay its debts either at the time the transfer was made or as a result of the transfer itself. The Code also allows actions to be brought under applicable state fraudulent conveyance statutes if such actions are commenced within the applicable fraudulent conveyance statute of limitations. The applicable statute of limitations under state statutes may be four years or more.

K. Preferential Transfers

The Act allows the FDIC to avoid a transfer of an interest of the CFC in real property that is a preferential transfer. A transfer is deemed preferential if it is made (a) to benefit the creditor, (b) on account of an antecedent debt, (c) while the CFC was insolvent, (d) 90 days on or before the FDIC became receiver (or between 90 days and one year if the creditor was an insider at the time of transfer), and (e) so that the transfer enabled the creditor to receive more than it would have during liquidation. For the purposes of avoiding a preferential transfer, the Act presumes the CFC is insolvent 90 days before the appointment of the FDIC as receiver.

The FDIC can recover the property transferred or the value of the property from the initial transferee or from any immediate or mediate transferee. The FDIC cannot recover from any initial transferee that takes for value, without knowledge of the transfer's potential voidability or any immediate or mediate good faith transferee of such initial transferee. A transferee would have the defenses provided under Sections 546(b) and (c), 547(c), and 548(c) of the Code, noted above, and would have the same defenses available to such transferee in an action brought under Sections 547, 548, and 549 of the Code. **Sec. 210(a)(11) (pp. 98-100)**.

Under the Code, the DIP or trustee may avoid a transfer of an interest of the debtor in any property to or for the benefit of a creditor, on account of an antecedent debt, which was made while the debtor was insolvent, that enables such creditor to receive more than it would have otherwise received, if that transfer was made within 90 days before the date of the filing of the petition. This period is extended from 90 days to one year if the creditor was an "insider." In addition, under Section 544 of the Code, the trustee is authorized to avoid transfers under applicable state law, which often provides for longer time periods. The Code provides that interests in any type of property, not merely real property, are subject to avoidance, in contrast with the Act.

Preferential transfers may include payments of amounts due to existing creditors or grants of new security interests to secure obligations owed to existing creditors. Defenses include that the transfer was made for new value or in the ordinary course of business. While the Act provides similar defenses, it fails to incorporate an important defense found at Section 546(e) of the Code. That section provides that the DIP/trustee may not avoid a transfer that is a margin payment or a settlement payment. This is a potentially significant omission which impacts, among others, financial institutions or security clearing agencies (and their transferees) that receive settlement payments under forward contracts.

L. Set-Off Rights

Under the Act, a creditor can enforce its rights under applicable law to offset a mutual debt owed by the creditor to the CFC that arose before the FDIC was appointed as receiver. Such setoff, however, is not enforceable if (a) the claim of the creditor is disallowed, (b) the claim was transferred by an entity other than the CFC to the creditor after the FDIC was appointed as receiver or after 90 days before the date on which the FDIC was appointed as receiver and while the CFC was insolvent (except for a setoff in connection with a QFC), or (c) the debt owed to the CFC was incurred by the CFC after 90 days before the date on which the FDIC was appointed as receiver, while the CFC was insolvent and for the purpose of obtaining a right of setoff against the CFC (except for a setoff in connection with a QFC).

The FDIC, however, can object to any portion of any setoff that is not proven to its satisfaction. Further, the FDIC can sell or transfer any assets free and clear of any set-off rights of a party. Such creditors receive an unsecured claim equal to the setoff at a priority level junior to certain priority claims but senior to other senior or general liabilities of the CFC. **Sec. 210(a)(12) (pp. 100-101)**.

*The same creditor has far greater protections under the Code. While the set-off rules are largely the same—*i.e.*, the requirement for mutual debt and limitations on the right of setoff—*

under the Code, a party with set-off rights is treated much the same as a secured creditor. Unlike the Act, set-off rights cannot be evaded by sale or transfer of an asset free and clear of set-off rights and there is no concept of subordination of a valid set-off claim.

M. Liquidation of Covered Brokers and Dealers

As noted above, if an Orderly Liquidation Authority commences on a CBD, the FDIC will be appointed as the receiver of the CBD and the SIPC will be appointed as the trustee for the CBD. As the trustee, the SIPC is tasked with filing for a protective decree under the SIPA and liquidating the CBD. The SIPC has the powers and duties provided under the SIPA for trustees. Such powers and duties, however, do not apply to assets and liabilities that are transferred to a Bridge Company. The SIPC's powers do not abridge the FDIC's powers to make funds available to the CFC; organize, establish, operate, or terminate any Bridge Company; transfer assets and liabilities; enforce or repudiate contracts; take any action related to a Bridge Company; or determine claims.

All customer claims of CBDs will be resolved in the same manner and for the same amount as under the SIPA. Any obligation of a CBD to a customer relating to customer property will be paid in an amount that is at least as beneficial to the customer as if the CBD had been subject to a proceeding under the SIPA or by delivering the securities to the customer. **Sec. 205 (pp. 82-85)**. The Act sets the maximum liability for a customer of a CBD at the amount the customer would have received from its customer property in a case initiated by the SIPC under the SIPA, determined on the close of business of the day the FDIC is appointed as receiver. **Sec. 210(d)(3) (p. 122)**.

N. Mandatory Terms for All Orderly Liquidations

The Act requires the FDIC, in taking any action under the Orderly Liquidation Authority, to: (a) determine that such action is necessary for the financial stability of the United States; (b) ensure that the shareholders of the CFC do not receive payment until all other claims and the Fund are paid; (c) ensure that unsecured creditors bear losses in accordance with their priority order; (d) ensure that management responsible for the failed condition of the CFC are removed; (e) ensure that members of the board of directors responsible for the failed condition are removed; and (f) not take an equity interest in the CFC. **Sec. 206 (pp. 85-86)**.

O. Recoupment of Senior Executive and Director Compensation

The Act allows the FDIC to recover from any current or former executive or director substantially responsible for the failed condition of the CFC any compensation received from two years prior to appointment of the FDIC as receiver. In cases of fraud, no time limit would exist for the FDIC's ability to recover such compensation. **Sec. 210(s) (p. 142)**.

P. Reporting Requirements

The Act requires several reports:

i. Within 60 days after the appointment of the FDIC as receiver, the FDIC is required to prepare reports on the CFC's assets and liabilities. Such reports will be filed with several House and Senate committees and published online.

ii. The FDIC is required to maintain a full accounting of each receivership of any CFC and file an annual report on such receiverships to the Secretary and the Comptroller General. The Comptroller General will review and report to Congress any determination to use the Orderly Liquidation Authority and, along with the Administrative Office of the United States Courts, conduct a study regarding the orderly liquidation process for financial companies under the Code.

iii. The Comptroller General is required to conduct a study regarding international coordination relating to the liquidation of financial companies under the Code.

iv. The FDIC Inspector General will conduct audits and investigations on the liquidation of the CFC by the FDIC under Title II.

v. The Inspector General of the Treasury will conduct audits and investigations on the actions taken by the Secretary relating to the liquidation of a CFC under Title II.

vi. The Inspector General of the CFC's primary federal regulatory agency or the Fed (if no federal regulatory agency exists) will issue a written report evaluating the effectiveness of the agency or the Fed in supervising the CFC. **Sec. 202(e)-(g), 203(c) (pp. 75-76 and 78-80)**.

TITLE III: Termination of OTS and Transfer of its Powers to the OCC, the FDIC, and the Fed

A. Introduction

Under current law, the Office of Thrift Supervision ("OTS") is the Federal bank regulator and overseer of all federal and most state-chartered thrift institutions, as well as their holding companies. Title III abolishes the OTS and transfers its functions to the Fed, the OCC, and the FDIC. The stated purpose of such changes are: (1) to provide for the safe and sound operation of the U.S. banking system; (2) to preserve and protect the dual system of federal and state-chartered depository institutions; (3) to ensure the fair and appropriate supervision of each depository institution; and (4) to streamline and rationalize the supervision of depository institutions and their holding companies. **Sec. 301 (p. 148)**.

Under Title III, the OCC assumes all former responsibilities and authorities of the OTS other than those with respect to SLHCs and state savings associations. The Fed is responsible for all former OTS authorities (including rulemaking) related to SLHCs, while the FDIC assumes functions related to the regulation of state savings associations. **Sec. 312 (pp. 149-151)**.

The transfer date is one year after enactment, unless extended for up to 180 days. **Sec. 311 (p. 149)**. To satisfy statutory "PAY-GO" requirements, Title III amends the formula for FDIC assessments of depository institutions, as added during the reconvening of the House-Senate Conference, in order to replace a portion of a $19 billion bank tax that created political difficulties for the entire bill. In general, Title III takes effect on the transfer date. The OTS is abolished 90 days after the transfer date. **Sec. 313 (p. 151)**. The FDIC deposit insurance reforms are effective one day after the date of enactment.

B. Transfer of OTS's Functions Related to SLHCs

Title III transfers all the functions of the OTS related to the supervision of any SLHC and any subsidiary (other than a depository institution) of a SLHC to the Fed. **Sec. 312(b) (pp. 149-150)**.

The Fed inherits the rulemaking authority of the OTS with respect to all SLHCs. The Fed also assumes OTS's rulemaking authority under Section 11 of the Home Owner's Loan Act (12 U.S.C. § 1468) relating to transactions with affiliates and extensions of credit to executive officers, directors, and principal shareholders. **Sec. 312(b) (pp. 149-150)**.

C. Transfer of OTS' Functions Related to Savings Associations

All functions of the OTS and the Director of the OTS related to federal savings associations are transferred to the OCC. The FDIC assumes all functions of the OTS and the Director of the OTS relating to state savings associations. **Sec. 312(b) (p. 150)**.

OTS' rulemaking authority relating to savings associations is transferred to the OCC. **Sec. 312(b) (p. 150)**.

D. Appropriate Federal Banking Agency

1. The OCC

Title III amends Section 3 of the FDI Act (12 U.S.C. 1813), Subsection (q) making the OCC the "appropriate federal banking agency" in the case of any national banking association, any federal branch or agency of a foreign bank, and any federal savings association. **Sec. 312(c) (p. 150)**.

2. The FDIC

Additional changes to Section 3, Subsection (q) of the FDI Act, make the FDIC the "appropriate federal banking agency" in the case of any insured State bank, any foreign bank having an insured branch, and any State savings association. **Sec. 312(c) (p. 151)**.

3. The Fed

Further amendments to the FDI Act provide that the Fed is the "appropriate federal banking agency" in the case of any State member bank, any branch or agency of a foreign bank with respect to any provision of the Federal Reserve Act ("FR Act") which is made applicable under the International Banking Act of 1978, any foreign bank which does not operate an insured branch; any agency or commercial lending company other than a Federal agency, supervisory, or regulatory proceedings arising from the authority given to the Fed under Section 7(c)(1) of the International Banking Act, any bank holding company and its subsidiaries (other than depository institutions), and any savings and loan holding and its subsidiaries. **Sec. 312(c) (p. 151)**.

E. Transfer Date of the Functions of the OTS

The date for the transfer of functions to the OCC, the FDIC, and the Fed is one year after the date of enactment of the Act. **Sec. 311(a) (p. 149)**.

An extension is permitted if the Secretary, in consultation with the Comptroller and the Director of the OTS, transmits a request for such an extension to the Senate Banking Committee and House Financial Services Committee. The request must include a written determination that "orderly implementation" of this subtitle is not feasible within the established time frame, an explanation of why the extension is necessary, and a description of the steps that will be taken to effect the implementation of the power transfer within the extended time period. In no case is the date for power transfer later than 18 months after the title's enactment. **Sec. 311(b) (p. 149)**.

F. The OCC as Successor to OTS

1. Abolishment of OTS

Title III abolishes the OTS and the position of Director of OTS and is effective 90 days after the transfer date. **Sec. 313 (p. 151)**.

2. The OCC

Section 324 of the Revised Statutes of the United States (12 U.S.C. 1) is restated to reflect the transfer of OTS authority to the OCC. The OCC remains a bureau in the Department of the Treasury. It is charged "with assuring the safety and soundness of, and compliance with laws and regulations, fair access to financial services, and fair treatment of customers, by the institutions and other persons subject to its jurisdiction." As it is now, the chief officer of the OCC is the Comptroller, who performs his/her duties under the general direction of the Secretary. Upon the transfer date, the Comptroller is vested with the same authority as was previously vested in the Director of OTS. **Sec. 314(a) (pp. 151-152)**.

Additionally, the Comptroller must appoint a Deputy Comptroller responsible for the supervision and examination of federal savings associations. **Sec. 314(b) (p. 152)**.

3. Savings Provisions

a) Existing Rights, Duties, and Obligations of OTS Not Affected

The transfer of powers away from OTS does not affect the validity of any right, duty, or obligation of the United States, the Director of OTS, the OTS, or any other person that existed on the day before the transfer. **Sec. 316(a)(1) (p. 152)**.

Furthermore, the subtitle transferring powers does not abate any action or proceeding commenced by or against the OTS or its Director. However, for any action or proceeding arising out of a function of the OTS Director that is transferred to the Comptroller, the Comptroller needs to be substituted for the OTS or its Director as a party to the action or proceeding as of the transfer date. The same is said for the FDIC and the Fed related to those powers which it assumes from OTS—if there is an action or proceeding related to these powers, the Chairperson of the FDIC or the Chairman of the Fed would have to be substituted for the Director of the OTS as a party to the action. **Sec. 316(a)(2) (pp. 152-153)**.

b) Continuation of Existing Orders, Resolutions, Determinations, and Agreements

All orders, resolutions, determinations, agreements, regulations, interpretative rules, guidelines, procedures, and other advisory materials that have been issued, made, prescribed, or allowed to become effective by the OTS or the Fed (or by a court of competent jurisdiction) and that relate to the functions transferred by Title III and are in effect on the day before the transfer date continue in effect according to their terms. Further, such actions are enforceable by and against the OCC, the Fed, and the FDIC (with respect to the OTS powers transferred to each of these entities) until modified, terminated, set aside, or superseded in accordance with applicable law by the OCC, the Fed, the FDCI, a court of competent jurisdiction, or the operation of law. **Sec. 316(b) (pp. 153)**.

c) Continuation of Regulations

Before the transfer date, the Comptroller, after consulting with the Chairperson of the FDIC, is required to identify the regulations that will continue to be enforced by the OCC and publish a list of such regulations. Likewise, the FDIC and the Fed are required, in consultation with the Comptroller, to identify those regulations that will be enforced by the FDIC and the Fed and publish a list of such regulations. **Sec. 316(c) (pp. 153-154)**.

Regulations that have been proposed by the OTS before the transfer date, but have not yet been published as final regulation, will be deemed to be a proposed regulation of the OCC, the FDIC, or the Fed, as appropriate. With respect to interim or final regulations that the OTS has published before the transfer date but have not yet become effective, they become effective as a regulation of the OCC or the FDIC, as appropriate. **Sec. 316(d) (p. 154)**.

d) References in Federal Law to Federal Banking Agencies

Any reference in federal law to the Director of the OTS or the OTS is deemed a reference to the Comptroller of the Currency, the OCC, the Chairperson of the FDIC, the FDIC, the Chairman of the Fed, or the Fed, as appropriate, except as provided in Section 213(d)(2) as to changes in the BHC Act. **Sec. 317 (p. 154)**.

4. Funding and Assessments

Title III amends current law to allow the Comptroller to collect an assessment, fee, or other charge from any entity described in Section 3(q)(1) of the FDI Act, as the Comptroller determines necessary or appropriate to carry out the responsibilities of the OCC. In establishing the amount of such an assessment, the Comptroller can take into account the funds transferred to the OCC under this section, the nature and scope of activities of the entity, the amount and type of assets that entity holds, the financial and managerial condition of the entity, and any other factor, as the Comptroller determines appropriate. The Comptroller alone has the authority to determine the manner in which the obligations of the Office will be incurred and its disbursements and expenses allowed to be paid. **Sec. 318(b) (p. 155)**.

Title III also amends the FR Act, directing the Fed to collect the total amount of assessments, fees, or other charges from: (1) BHCs with total consolidated assets of $50 billion or more; (2) SLHCs with $50 billion or more; and (3) all NBFCs supervised by the Fed under Section 113 of this Act. **Sec. 318(c) (pp. 155-156)**.

The cost of conducting any regular or special examination of any depository institution may be assessed by the FDIC against the institution to meet the FDIC's expenses, or as the FDIC determines is necessary or appropriate to carry out its responsibilities. **Sec. 318(d) (p. 156)**.

These amendments take effect on the transfer date. **Sec. 318(e) (p. 156)**.

5. Administrative Provisions Related to the Transfer

Title III contains a number of administrative provisions related to the transfer of power from OTS to OCC, the Fed and the FDIC. Such provisions cover the following topics:

i. Coordination of transition activities **(Sec. 321; pp. 156-157)**;

ii. Interim responsibilities **(Sec. 321; p. 157)**;

iii. Transfer of employees **(Sec. 322; pp. 157-163)**;

iv. Transfer of property **(Sec. 323; pp. 163-164)**;

v. Transfer of funds **(Sec. 324; p. 164)**;

vi. Disposition of the OTS's affairs **(Sec. 325; p. 165)**;

vii. Continuation of services provided to the OTS by other U.S. agencies or departments to the OCC **(Sec. 326; p. 165)**; and

viii. Contracting and leasing authority of Comptroller **(Sec. 319; p. 156)**.

6. Implementation Plan and Reports

Within 6 months of enactment, the Fed, FDIC, OCC, and OTS must submit a joint plan detailing the transfer of OTS authority. **Sec. 327 (pp. 165-166)**.

G. Reforms to FDIC Assessments

1. Size Distinctions

Title III eliminates Section 7(b)(2)(D) of the FDI Act, which prohibits discrimination based on size. Section 7(b)(2)(D) currently states that "no insured depository institution shall be barred from the lowest-risk category solely because of size." **Sec. 331(a) (pp. 166-167)**.

2. Assessment Base

Under Title III, the FDIC is required to amend the way in which it calculates an assessment base with regards to an insured depository institution for the purposes of Section 7(b)(2) of the FDI Act. Namely, the assessment base would be equal to the average total consolidated assets of the insured depository institution during the assessment period, minus the sum of the average tangible equity of the insured depository institution during the assessment period, and, in the case of a custodial bank (as defined by the FDIC based on factors including the percentage of total revenues generated by custodial businesses) or a banker's bank (as that term is used in 12 U.S.C. Section 24), an amount that the FDIC determines is necessary to establish assessments consistent with the definition under Section 7(b)(1) of the FDI Act of a custodial bank or banker's bank. **Sec. 331(b) (p. 167)**.

3. Elimination of Procyclical Assessments

Section 7(e) of the FDI Act is amended to allow the Board of Directors, in its discretion, to suspend or limit the payment of dividends and to require the FDIC to issue regulations that state the method for the declaration, calculation, distribution, and payment of dividends. **Sec. 332 (p. 167)**.

4. Amended Reserve Ratio Requirements

Title III amends Section 7(b)(3)(B) of the FDI Act to increase the minimum reserve ratio requirements to be "not less than 1.35 percent" of insured deposits with a target date of September 30, 2020 to reach this ratio and an offset of the increase for depository institutions with less than $10 billion in assets. **Sec. 334 (pp. 167-168)**.

5. Permanent Increase in Deposit and Share Insurance

Title III makes permanent the increase from $100,000 to $250,000 in the maximum FDIC deposit insurance and credit union share insurance, retroactive to January 1, 2008. **Sec. 335 (p. 168)**.

6. FDIC Management

Title III amends Section 2 of the FDI Act so as to replace the Director of the OTS with the Director of the Bureau on the Board of Directors of the FDIC. Further, in the event of a vacancy in the OCC, the acting Comptroller will be a member of the Board of Directors. **Sec. 336 (pp. 168-169)**.

H. Other Matters

1. Branching

Under Title III, notwithstanding the FDI Act, the BHC Act, or any other provision of federal or state law, a savings association that becomes a bank can continue to operate any branch or agency that the savings association operated immediately before the savings association became a bank. **Sec. 341 (p. 169)**.

2. Office of Minority and Women Inclusion

Title III directs each agency to establish an Office of Minority and Women Inclusion within 6 months of enactment. This office will be responsible for matters relating to diversity in management, employment, and business activities but will not have authority to enforce statutes, regulations, or executive orders pertaining to civil rights. The office will be headed by a Director who will develop standards for equal employment opportunity and workplace diversity, increased participation by minority- and women-owned businesses in the programs and contracts of the agency, and assessing the diversity policies and practices of entities regulated by the agency. **Sec. 342 (pp. 169-170)**.

The Director will also develop a procedure through which the Director will determine whether an agency contractor or subcontractor has failed to make a good faith effort to include minorities and women in the workforce. If the Director makes this determination, he/she will recommend to the agency administrator that the contract be terminated. The agency administrator may terminate the contract, refer it to the Office of Federal Contract Compliance Programs of the Department of Labor or take other appropriate action. **Sec. 342 (pp. 170-171)**.

3. Insurance of Transactions Accounts

Under an agreement reached by the Conference, the title temporarily extends, until 2013, the Transaction Account Guarantee Program, which insures noninterest bearing transaction accounts above standard FDIC limits. It also provides authority for the establishment of a similar program for credit unions. **Sec. 343 (pp. 172-174)**.

TITLE IV: Regulation of Advisers to Hedge Funds and Others

The Private Fund Investment Advisers Registration Act of 2010 (the "PFIARA"), Title IV of the Act, requires that investment advisers to hedge funds, private equity funds, real estate funds, and certain other private funds with assets under management ("AUM") of $150 million or more register with the SEC, comply with certain SEC books, records, and reporting requirements, and be subject to periodic SEC examination. Advisers to venture capital funds will not be required to register with the SEC, but will be required to maintain records and provide annual and other reports prescribed by the SEC. These amendments become effective one year after the enactment of the Act.

The Act provides exemptions from registration for family offices and certain foreign private advisers with fewer than 15 clients and investors, and also provides a limited intrastate exemption.

A. Exemptions

1. Elimination of Private Adviser Exemption

The Act amends Section 203(b)(3) of the Investment Advisers Act of 1940 ("Advisers Act") to eliminate the 15 or fewer client exemption that currently allows many advisers to avoid registration with the SEC. Accordingly, advisers to hedge funds and private equity funds will be required to register with the SEC if they have at least $150 million of AUM. **Sec. 403 (p. 200)**. A "private fund" is defined as an issuer that would be an investment company, as defined in Section 3 of the 1940 Act, but for Section 3(c)(1) or 3(c)(7) thereof. **Sec. 402 (p. 199)**.

The SEC is prohibited from defining the term "client" for purposes of the Advisers Act's antifraud provision, Section 206, to include an investor in a private fund managed by an investment adviser if the fund has entered into an advisory contract with the adviser**. Sec. 406 (p. 203).**

This provision will require the registration of many previously exempted investment advisers to hedge funds and private equity funds, although the threshold for SEC registration will be reset to at least $100 million AUM.

2. Limited Foreign Private Adviser Exemption

The exemption for foreign private advisers is narrower than under current Section 203(b)(3) of the Advisers Act because, among other things, it requires the adviser to look through the private fund and count the number of U.S. investors in the fund as well as the fund itself in determining whether the adviser exceeds the limit of 15 clients <u>and</u> investors in the United States. **Sec. 403 (p. 200)**. To be exempt, an investment adviser must meet the definition of "foreign private adviser," which means that it:

i. Has no place of business in the United States;

ii. Has, in total, fewer than 15 clients and investors in the United

States in private funds advised by the investment adviser;

iii. Has aggregate AUM attributable to clients in the United States and investors in the United States in private funds advised by the investment adviser of less than $25 million, or such higher amount as the SEC may determine through rulemaking; and

iv. Neither holds itself out generally to the public in the United States as an investment adviser; nor acts as an investment adviser to (i) any investment company registered under the 1940 Act, or (ii) a company that has elected to be a business development company under the 1940 Act (a "Business Development Company"). **Sec. 402 (p. 199).**

This provision could potentially bring many foreign investment advisers with very few U.S. contacts under the ambit of SEC registration. The narrowing of this exemption may ultimately affect foreign advisers' decisions on whether to seek U.S. investors.

3. Limited Intrastate Exemption

The intrastate exemption found in Section 203(b)(1) of the Advisers Act for advisers to funds whose clients are all residents of the state within which the adviser has its principal office and place of business is narrowed to exclude investment advisers to private funds, except for foreign private advisers, as discussed above. **Sec. 403 (p. 200)**.

4. Limited Small Business Investment Company Adviser Exemption

New Section 203(b)(7) exempts from registration investment advisers who solely advise:

i. Small business investment companies that are licensees under the Small Business Investment Act of 1958 ("Small Business Companies");

ii. Entities that have received from the Small Business Administration notice to proceed to qualify for a license as a Small Business Company, which notice or license has not been revoked; or

iii. Applicants that are affiliated with one or more Small Business Companies that have applied for another license, which application remains pending.

Advisers that are Business Development Companies, however, are not exempt. **Sec. 403 (p. 200)**.

5. Venture Capital Fund Advisers

New Section 203(*l*) of the Advisers Act exempts venture capital fund advisers from registration under the Advisers Act with respect to investment advice provided to venture capital funds. Even though not required to register with the SEC, venture capital fund advisers will be required to maintain such records and to provide annual or other reports to the SEC as the SEC deems necessary or appropriate in the public interest or for the protection of investors. The SEC is required to define the term "venture capital fund" within one year of enactment of the Act. **Sec. 407 (pp. 203-04)**.

The availability of this exemption will depend on the SEC's definition of "venture capital funds." Venture capital firms will want to provide input on the SEC's proposals to make sure that they are included within the definition, and advisers to other private funds will want to evaluate whether the funds that they manage are more appropriately described as "venture capital funds." Moreover, the benefit of this exemption largely will depend upon the scope of the recordkeeping and reporting requirements promulgated by the SEC for venture capital funds.

6. Private Fund Advisers with AUM of Less Than $150 Million

The SEC has authority, pursuant to new Section 203(m) of the Advisers Act, to exempt from registration any investment adviser that solely advises private funds, as defined above, and has AUM in the United States of less than $150 million. Even if exempted from registration, such advisers must maintain records and provide to the SEC such annual or other reports as the SEC determines are appropriate. In developing registration requirements and examination procedures for these "mid-sized" private fund advisers, the SEC is required to take into account fund size, governance, investment strategy, and level of systemic risk posed by the fund. **Sec. 408 (p. 204)**.

As with advisers to venture capital funds, mid-size private fund advisers will need to await the SEC's coming rulemaking as to recordkeeping and reporting requirements that will be imposed on such advisers.

7. Family Offices

Section 202(a)(11)(G) of the Advisers Act is amended to exempt from the definition of "investment adviser" (and therefore, from registration) any family office, as that term is defined by the SEC. This definition is to be consistent with SEC exemptive orders in effect at the time of enactment of the Act and to recognize the range of organizational, management, and employment structures and arrangements utilized by family offices. Even if an investment adviser is exempt from registration under this provision, it will be subject to the antifraud provisions of Section 206 of the Advisers Act. **Sec. 409 (pp. 204-05)**.

Codification of the exemption through the SEC's definition of "family office" will eliminate the need for individual exemptions for family offices, but clients with family offices will want to review the SEC's definition, when proposed, to make sure that they are covered by the exemption.

B. Federal and State Jurisdiction

The AUM threshold for an investment adviser to register with the SEC was raised from $25 million to $100 million in Advisers Act Section 203A(a)(1). Accordingly, investment advisers that do not satisfy the higher AUM requirement will be required to register with the states rather than with the SEC, unless they are (1) advisers to an investment company registered under the 1940 Act, (2) Business Development Companies that have not withdrawn their election under the 1940 Act, or (3) required to register with 15 or more states. **Sec. 410 (pp. 205-06); Sec. 419 (p. 209)**.

This provision will require many mid-size investment advisers to register with one or more states rather than the SEC, although the Act includes a one-year transition period during which any adviser may, at its discretion, register with the SEC. It is possible that advisers who are currently registered with the SEC will be grandfathered in so that they can retain their registrations, even if they will not meet the new AUM requirement.

As a result of the increased burden on state regulators, we may see higher state registration and licensing fees, regulatory sharing agreements between states, and other changes to help the states manage their additional responsibilities and expenses.

C. Data, Reports, and Disclosures of Private Funds

New Section 204(b) of the Advisers Act requires registered investment advisers to maintain records and make reports to the SEC regarding private funds advised by the adviser, as determined by the SEC to be necessary in the public interest and for the protection of investors. The SEC is, in turn, required to provide such reports or records to the Council as the Council determines are necessary to assess the systemic risk of a private fund. For these purposes, the records of any private fund advised by an investment adviser would be deemed the records and reports of the investment adviser. The SEC is required to adopt rules specifying the types of records that private fund advisers must make, the retention period for such records, and the reports such advisers will be required to file. **Sec. 404 (pp. 200-01)**.

1. Required Information; Consultation with the Council

The records and reports required to be maintained by an investment adviser and subject to SEC inspection include, for each private fund, a description of:

i. The amount of AUM and use of leverage, including off-balance sheet leverage;

ii. Counterparty credit risk exposure;

iii. Trading and investment positions;

iv. Valuation policies and practices of the fund;

v. Types of assets held;

vi. Side arrangements or side letters whereby certain investors in the fund obtain more favorable rights or entitlements than other investors;

vii. Trading practices; and

viii. Such other information as the SEC determines, in consultation with the Council, is necessary and appropriate in the public interest and for the protection of investors or for the assessment of systemic risk. This could result in different reporting requirements for different classes of private fund advisers based on the type or size of the fund being advised. **Sec. 404 (p. 201).**

2. Examinations of Records and Confidentiality

Records of private funds that are maintained by a registered investment adviser are subject to periodic, special, and other examination by the SEC at any time and from time to time, as the SEC may prescribe as necessary and appropriate. The SEC is required to make available to the Council all reports, documents, records, and information filed with or provided to the SEC by an investment adviser to a private fund for systemic risk assessment purposes. All such reports, documents, records, and information obtained from the SEC under this section would be required to be kept confidential pursuant to Section 204(b)(8) of the Advisers Act.

The SEC is also required to provide this information to: (a) Congress, upon an agreement of confidentiality; (b) any other federal department or agency or SRO requesting information or reports for purposes within the scope of its jurisdiction; or (c) pursuant to a court order in an action brought by the SEC or otherwise by the U.S. government. The Council and any department, agency, or SRO that receives information or reports from the SEC is subject to the same level of confidentiality as the SEC. In addition, all such parties are exempt from the requirements of the Freedom of Information Act (5 U.S.C. §552) ("FOIA"), which compels federal agencies to disclose to the public any records requested in writing, unless such records are protected by an exemption under FOIA.

Any "proprietary information" of an investment adviser that the SEC ascertains from any report required to be filed with the SEC is subject to the same limitations on public disclosure as any facts ascertained during an examination as set forth in Section 210(b) of the Advisers Act. "Proprietary information" includes sensitive, non-public information regarding an adviser's investment or trading strategies, analytical or research methodologies, trading data, computer hardware or software containing intellectual property, and other information the SEC determines is proprietary. **Sec. 404 (pp. 201-03)**.

Section 210(c) of the Advisers Act now authorizes the SEC to disclose the identity of an investment adviser's clients for the purpose of assessing potential systemic risks as well as in connection with a proceeding or investigation relating to the enforcement of the Advisers Act. **Sec. 405 (p. 203)**.

It is not yet known what the examination protocols will be with respect to registered investment advisers to private funds. While the SEC's examinations of private fund records initially may be broad, as SEC staff develops additional experience with the private funds generally and with the newly registered advisers specifically, we may see more tailored examination protocols. The scope of information that will be required and shared among regulators in order to assess systemic risk remains a concern, particularly with respect to sensitive information such as client identity.

D. Dual SEC-CFTC Registered Advisers

Within one year of enactment of the Act, and after consultation with the Council, the SEC and the CFTC are required to jointly promulgate rules to establish the form and content of reports required to be filed with the SEC and CFTC by investment advisers that are dually registered with both agencies. **Sec. 406 (p. 203)**.

E. Custody of Client Accounts

New Advisers Act Section 223 requires registered investment advisers to take SEC-prescribed steps to safeguard client assets over which they have custody, including but not limited to verification of such assets by an independent public accountant. **Sec. 411 (p. 206)**.

The Comptroller General is required to conduct a study on the compliance costs associated with the current SEC rules regarding custody of funds or securities of clients of investment advisers as well as the additional costs if the provisions relating to operational independence are eliminated. The report is due to the Banking Committees within three years of the Act's enactment. **Sec. 412 (p.206)**.

F. Adjustment of the Accredited Investor Standard

The Act increases the net worth standard for an "accredited investor," as defined by the SEC under the Securities Act of 1933 (the "1933 Act") to more than $1 million of net worth, excluding the value of an individual's primary residence, for a natural person, or joint net worth with spouse, at the time of purchase. During the first four years following enactment of the PFIARA, the net worth standard is set at $1 million, excluding the person's primary residence. **Sec. 413 (pp. 206-07)**.

The SEC is directed to review the definition of "accredited investor" as it applies to natural persons to determine if any adjustments should be made to the requirements, other than to the net worth standard, for investor protection, public interest purposes, and in light of the economy. Beginning four years after enactment of the PFIARA, and every four years thereafter, the SEC is directed to review the definition of "accredited investor" in its entirety to determine if it should be modified for investor protection, public interest purposes, and in light of the economy. **Sec. 413 (p. 207)**.

The Act also requires that all dollar amount tests employed with respect to any factor used in any SEC rule or regulation promulgated with respect to Advisers Act Section 205(e), including the net asset threshold test, be adjusted one year after enactment of the PFIARA and every five years thereafter for the effects of inflation. **Sec. 418 (p. 208)**.

The Comptroller is required to conduct a study on the appropriate criteria for determining financial thresholds or other criteria needed to qualify for accredited investor status and eligibility to invest in private funds. The report is due to the Senate Banking Committee and House Financial Services Committee within three years of enactment of the PFIARA. **Sec. 415 (p. 207)**.

This adjustment to the accredited investor standard does not apply retroactively.

Additional adjustments to the accredited investor standard may be made in the next few years, following the completion of the Comptroller's report.

G. SRO for Private Funds

The Comptroller is required to conduct a study on the feasibility of forming an SRO to oversee private funds. The report is due within one year of enactment of the Act. **Sec. 416 (p. 208)**. This study is in addition to the SEC's study of the regulation and oversight of broker-dealers and investment advisers, which is due in six months, and is expected to address the issue of an SRO for investment advisers. If the Comptroller recommends the formation of an SRO, it is unclear at this point who would comprise the entity, the scope of its regulatory authority, and whether the states would incorporate the concept of an SRO into their regulatory regimes.

H. Short Selling Studies

The SEC's Office of Risk, Strategy, and Financial Innovation is required to conduct a study on the state of short selling on national securities exchanges and in over-the-counter markets, including the incidence of the failure to deliver shares sold short. The report, together with any recommendations for market improvements, is due within two years of enactment of the PFIARA. **Sec. 417 (p. 208)**.

This office is also required to conduct a study on the feasibility, benefits, and costs of requiring real-time reporting of short sale positions either publicly or to the SEC and the Financial Industry Regulation Authority and of conducting a voluntary pilot program by public companies in which the companies agree to have additional information about their trades reported in real time though the Consolidated Tape. This report is due within one year of enactment of the PFIARA. **Sec. 417 (p. 208)**.

The full impact of these studies, as well as the other studies required by the PFIARA, will not be known until they have been completed and any recommendations adopted or rejected. However, given the nature of the studies, heightened regulation of trading activities is possible in the next few years.

I. Effective Date

The PFIARA is effective within one year of enactment, however, during that one year period, investment advisers may register with the SEC under current standards, including the $24 million AUM threshold. **Sec. 419 (p. 209)**.

TITLE V: Insurance

Subtitle A of Title V establishes a Federal Insurance Officer ("FIO") within the Treasury Department, which will primarily be an information gathering, monitoring and advisory agency. Title V does not provide FIO with general supervisory or regulatory authority over the business of insurance. Following enactment of Title V, the FIO will have 18 months to conduct a study and report on how to modernize and improve the U.S. system of insurance regulation and, in addition, will have to provide additional periodic reports to Congress. Subtitle A also provides that state insurance measures will be preempted if they: (i) result in less favorable treatment of a non-U.S. insurer domiciled in a foreign jurisdiction that is subject to an international prudential insurance agreement than a U.S. insurer domiciled or licensed in that state; or (ii) are otherwise inconsistent with an international prudential insurance agreement.

Subtitle B of Title V, the Nonadmitted and Reinsurance Reform Act of 2010, establishes certain regulatory reforms for nonadmitted (or surplus lines) insurance and for reinsurance generally. Under Subtitle B, only the home state of an insured may require premium tax payments for nonadmitted insurance. Congress intends that each state adopt uniform nationwide requirements and procedures for the reporting, collection, and allocation of premium taxes for nonadmitted insurance. In addition, the placement of nonadmitted insurance will be subject only to the regulatory requirements of the insured's home state, and only the insured's home state could require a surplus lines broker to be licensed to sell, solicit, or negotiate nonadmitted insurance with respect to the insured.

Subtitle B's reinsurance provisions relate to credit for reinsurance and the preemption of certain state laws as they relate to ceding insurers. The legislation provides that if a ceding insurer's state of domicile is accredited by the National Association of Insurance Commissioners ("NAIC") and recognizes credit for reinsurance for the insurer's ceded risk, then other states cannot not deny credit for reinsurance. Further, all regulations of a state that is not the domicile of the ceding insurer (except those with respect to taxes and assessments) will be pre-empted to the extent that they restrict the rights of the ceding insurer to resolve disputes under contractual arbitration or otherwise apply the state's laws to reinsurance agreements of ceding insurers not domiciled in that state. The provisions also limit the regulation of the financial solvency of a reinsurer to its domiciliary state if the state is NAIC accredited.

A. Establishment of Federal Insurance Office

Title V establishes the FIO within the Treasury Department. The FIO is headed by a Director, to be appointed by the Secretary. **Sec. 502 (p. 209)**.

1. Functions of FIO

The scope of the FIO's authority extends to all lines of insurance except health insurance and certain long-term care insurance. Among other things, FIO will be charged with:

i. Monitoring the insurance industry, consulting with the states on insurance matters, identifying issues that could contribute to a systemic crisis, and recommending that an insurer be designated as an entity subject to regulation as a NBFC;

ii. Monitoring the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable insurance products;

iii. Coordinating federal efforts and developing policy on prudential aspects of international insurance matters, advising the Secretary on major domestic and prudential international insurance policy issues, and assisting the Secretary in negotiating international prudential insurance agreements;

iv. Determining whether state insurance measures are preempted by "covered agreements";[10]

v. Consulting with states and state insurance regulators regarding insurance matters of national and international importance;

vi. Performing such other related duties as may be assigned by the Secretary;

vii. Advising the Secretary on major domestic and prudential international insurance policy issues; and

viii. Serving (Director of FIO) in an advisory capacity on the Financial Council. **Sec. 502 (pp. 209-210)**.

2. Collection of Information From Insurers

In order to carry out these functions, the FIO is authorized to receive and collect data and information from the insurance industry and insurers. Before collecting any such data or information, the FIO needs to coordinate with each relevant federal agency and state insurance regulator (or other relevant federal or state regulatory agency in the case of an affiliate of an insurer) and any publicly available sources to determine if the information can be obtained from the agency, regulator, or another publicly available source. The Director can, upon a written finding, require by subpoena an insurer to produce data or information necessary for the FIO to

10 The term "covered agreement" refers to a written bilateral or multilateral agreement entered into between the United States and a foreign government, authority, or regulatory entity regarding prudential measurers applicable to the business of insurance or reinsurance.

carry out its functions. The Director, however, cannot require a small insurer to submit such data or information, with the threshold for the minimum size for such exemption to be established by the FIO. **Sec. 502 (pp. 210-212)**.

3. Preemption of State Insurance Measures

With regard to preemption of state insurance measures, Title V prescribes that a state insurance measure is preempted only to the extent that such measure (1) results in less favorable treatment of a non-U.S. insurer domiciled in a foreign jurisdiction that is subject to a covered agreement than a U.S. insurer, and (2) is inconsistent with a covered agreement. Before making a determination regarding such preemption, the Director needs to:

i. Notify and consult with the appropriate State regarding any potential inconsistency or preemption;

ii. Notify and consult with the U.S. Trade Representative regarding potential inconsistency or preemption;

iii. Publish in the Federal Register notice of the issue regarding potential inconsistency or preemption, including a description of each state insurance measure at issue and any applicable covered agreement; and

iv. Provide interested parties a reasonable opportunity to submit written comments to the FIO.

Title V clarifies that the FIO does not have authority to preempt any state insurance measure governing rates, premiums, underwriting, sales practices, coverage requirements, or state antitrust laws applicable to insurance. Further, nothing in this section preempts any state insurance measure governing the capital or solvency of an insurer except to the extent that such state insurance measure directly results in less favorable treatment of a non-U.S. insurer. Finally, nothing in this section establishes or provides the FIO or the Treasury Department with general supervisory or regulatory authority over the business of insurance. **Sec. 502 (pp. 212-214)**.

4. Annual Reports

Title V provides that, beginning on September 30, 2011, the Director of the FIO will be required to submit to the President and to the respective House Committees on Financial Services and Ways and Means and the respective Senate Committees on Banking and Finance an annual report that describes any actions taken by the FIO regarding the preemption of state insurance measures. Also, beginning on September 30, 2011, the Director will be required to submit to the President and to the House Financial Services Committee and the Senate Banking Committee an annual report on the insurance industry and any other information as deemed relevant by the Director or requested by such committees.

Title V will also call on the Director to submit to the House Financial Services Committee and the Senate Banking Committee, not later than September 30, 2012, a report describing the breadth and scope of the global reinsurance market and the critical role such market plays in supporting insurance in the United States. In addition, the Director will be required to submit to the noted committees, not later than January 1, 2013, a report describing the impact of the Nonadmitted and Reinsurance Reform Act of 2010 (Subtitle B of Title V). **Sec. 502 (p. 214)**.

5. Study and Report on Regulation of Insurance

Finally, no later than 18 months after Title V is enacted, the Director is required to conduct a study and submit a report to Congress on how to modernize and improve the system of insurance regulation in the United States. This study and report will be guided by considerations of systemic risk regulation, capital standards, consumer protection, the degree of national uniformity of state insurance regulation, the regulation of insurance companies and affiliates on a consolidated basis, and international coordination of insurance regulation. The legislation also enumerates additional factors that the study should examine including the costs, benefits, feasibility, and effects of potential federal regulation of insurance, as well as the potential consequences of subjecting insurance companies to a federal resolution authority.

Title V requires that the study and report contain any legislative, administrative, or regulatory recommendations as the Director determines appropriate to carry out or effectuate the findings of the report. **Sec. 502 (pp. 215-216)**.

6. Covered Agreements

Under Title V, the Secretary and the U.S. Trade Representative will be authorized, jointly, to negotiate and enter into covered agreements on behalf of the United States. In doing so, the Secretary and the U.S. Trade Representative will jointly consult with the respective House Committees on Financial Services and Ways and Means and the respective Senate Committees on Banking and Finance. **Sec. 502 (pp. 217-218)**.

B. State-Based Insurance Reforms

Subtitle B of Title V, the "Nonadmitted and Reinsurance Reform Act of 2010," provides for state-based reforms that seek to streamline the regulation of surplus lines of insurance and reinsurance. These reforms will take effect one year after the subtitle in enacted. **Sec. 512 (p. 218)**.

1. Nonadmitted Insurance[11]

Under Subtitle B, no state other than the home state[12] of an insured can require any premium tax payment for nonadmitted insurance. States can enter into a compact to allocate among themselves the premium taxes paid to an insured's home state and, according to the legislation, Congress intends that each state adopt nationwide uniform requirements, forms, and procedures that provide for the reporting, payment, collection, and allocation of such taxes. **Sec. 521(a-b) (pp. 218-219)**.

To facilitate the payment of premium taxes among the states, an insured's home state may require surplus lines brokers and insureds who have independently procured insurance to annually file tax allocation reports with the insured's home state detailing the portion of the nonadmitted insurance policy premium or premiums attributable to properties, risks, or exposures located in each state. **Sec. 521(c) (p. 219)**.

Additionally, the placement of nonadmitted insurance will be subject to the statutory and regulatory requirements of the insured's home state only. Thus, the home state (and not any other state) can require a surplus lines broker to be licensed in order to sell, solicit, or negotiate such nonadmitted insurance. **Sec. 522 (p. 219)**.

Subtitle B also provides for uniform standards for surplus lines eligibility among states, as well as streamlined applications for surplus lines brokers who seek to procure nonadmitted insurance for commercial purchasers. **Sec. 524-525 (pp. 219-220)**.

Finally, the legislation directs the Comptroller General to conduct a study of the nonadmitted insurance market to determine the effect of these regulations on the size and market share of the nonadmitted insurance market for providing coverage typically provided by the admitted insurance market. **Sec. 526 (pp. 220-221)**.

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11 The term "nonadmitted insurance" means any property and casualty insurance permitted to be placed directly or through a surplus lines broker with a non-admitted insurer eligible to accept such insurance. A nonadmitted insurer means, with respect to a state, an insurer not licensed to engage in the business of insurance in such state.

12 The "home state" means, with respect to an insured, the state in which an insured maintains its principal place of business or, in the case of an individual, the individual's principal residence; or if 100 percent of the insured risk is located out of this state, the state in which the greatest percentage of the insured's taxable premium for that contract is allocated.

2. Reinsurance

Title V establishes regulations pertaining to credits for reinsurance and the preemption of certain state laws as it applies to a ceding insurer.[13] Namely, the legislation provides that if the domiciliary state[14] of a ceding insurer is a NAIC-accredited state and recognizes credit for reinsurance for the insurer's ceded risk, then other states will not be permitted to deny such credit. **Sec. 531(a) (p. 224)**.

Further, all laws, regulations, provisions, or other actions of a state that is not the domiciliary of the ceding insurer (except those with respect to taxes and assessments) are preempted to the extent that they restrict the rights of the ceding insurer to resolve disputes pursuant to contractual arbitration or otherwise apply the state's laws to reinsurance agreements of ceding insurers not domiciled in that state. **Sec. 531(b) (p. 224)**.

Finally, regulations of a state that is not the domicile of the ceding insurer (except those with respect to taxes and assessments) are pre-empted to the extent that they restrict the rights of the ceding insurer to resolve disputes under contractual arbitration or otherwise apply the state's laws to reinsurance agreements of ceding insurers not domiciled in that state. The regulation of the financial solvency of a reinsurer is limited to the reinsured's domiciliary state if the state is NAIC-accredited. **Sec. 532 (pp. 224-225)**.

13 A "ceding insurer," in the context of reinsurance, is the original or primary insurer which purchases reinsurance.

14 The "domiciliary state" refers to the state in which the insurer or reinsure is incorporated, or entered through, and licensed.

TITLE VI: Enhanced Regulation of Depository Institution Holding Companies

Title VI, the "Bank and Savings Association Holding Company and Depository Institution Regulatory Improvement Act of 2010," includes a significant number of new provisions and amendments to existing law that add financial and supervisory requirements and restrictions on depository institutions and their holding companies; and in some cases, those provisions also extend to Supervised NBFCs. For nonfinancial firms, it provides a new structure allowing transfer of regulation of SLHCs with nonfinancial activities to an IHC subsidiary, while barring a "commercial" firm from acquiring an industrial bank or credit card bank for at least three years. While most of the Title VI requirements tighten regulation of depository organizations, the title does provide two long-sought liberalizations—*de novo* interstate branching and interest-bearing demand deposit accounts for depository institutions.

Significantly, the title enhances capital requirements and includes an expansive version of the much discussed "Volcker Rule," based on proposals made by former Fed Chairman Paul Volcker. Provisions constituting the Volcker Rule include restrictions on capital markets activity by banks and BHCs, restrictions on proprietary trading, and limitations on relationships with hedge funds and private equity funds. Title VI also adds or amends a number of other provisions, including:

i. Requirements concerning examinations;

ii. A requirement that financial holding companies remain well capitalized and well managed;

iii. A source of strength requirement;

iv. A provision relating to interstate acquisitions;

v. Provisions relating to affiliate transactions;

vi. Lending limits applicable to credit exposure on derivative transactions, repurchase agreements, reverse repurchase agreements, and securities lending and borrowing transactions;

vii. Insider transactions;

viii. Securities holding companies; and

ix. Concentration limits.

A. New Credit Card Banks, Industrial Loan Companies, and Trust Banks Controlled by a Commercial Firm

1. Moratorium on New Commercial Firm Control of Credit Card Banks, Industrial Banks, and Trusts Banks

Title VI establishes a three-year moratorium during which "commercial firms" cannot establish new or acquire existing credit card banks, industrial banks, or trust banks.[15] **Sec. 603(a) (pp. 226-227)**. Under Section 602, a company is a "commercial firm" if the annual gross revenues derived by the company from control of insured depository institutions represent less than 15 percent of the consolidated gross revenues of the company. This definition limits the effect of the moratorium by not barring acquisitions by commercial firms that have significant financial activities. **Sec. 602 (p. 226)**.

The FDIC is barred from approving an application for deposit insurance for a industrial bank, a credit card bank, or a trust bank that is directly or indirectly owned or controlled by a commercial firm if the application was received after November 23, 2009. Federal banking agencies would be required to disapprove any change of control (under Section 7(j) of the FDI Act) over an industrial bank, credit card bank, or trust bank if the change would result in direct or indirect control of the bank shifting to a commercial firm. **Sec. 603(a) (p. 226)**. Note that the provision is silent with respect to merger acquisitions and does not appear to limit a merger in which the resulting institution is an institution that was previously controlled by a commercial firm.

The title provides three limited exceptions to the prohibition on a commercial firm gaining control of a credit card bank, industrial bank, or trust bank. A commercial firm can acquire such a bank when the bank is (1) in danger of default (as determined by the appropriate federal banking agency), (2) the change of control results from the acquisition of a commercial firm that controls the bank by another commercial firm (so that the bank was owned by a commercial firm both before and after the transaction), or (3) the change of control results from the acquisition of voting shares of a publicly traded company that controls the bank if, after the acquisition, the acquiring shareholders hold less than 25% of any class of voting shares of the company. **Sec. 603(a)(3)(B) (pp. 226-227)**.

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15 Dodd-Frank defines each of "credit card bank," "industrial bank," and "trust bank" by reference to the BHC Act, specifically BHC Act Sections 2(c)(2)(D), (F), and (H). **Sec. 603(a)(1)(A)-(C) (pp. 226)**.

2. GAO Study of SLHCs and Future Control of Credit Card Banks, Industrial Loan Companies, and Trust Banks by a Commercial Firm

During the three year moratorium discussed above, the Government Accountability Office ("GAO") is required to conduct a study of whether commercial companies should be permitted to own credit card banks, industrial banks, and trust banks. Specifically, the GAO is required to study whether it is necessary to eliminate these exceptions to the BHC definition in BHC Act Sections 2(a) and 2(c). **Sec. 603(b)(1) (p. 227)**. The study will not be required to address the implications of such a change for a company that already controls such institutions. If these exception are eliminated, then all future acquisitions of such institutions by a commercial firm will be barred and the ability of existing commercial firms to control such banking institutions would be subject to termination (unless grandfathered). The GAO study will identify the types and number of institutions excepted from BHC Act Section 2, determine the adequacy of the federal bank regulatory framework applicable to these institutions, and evaluate the potential consequences of subjecting these banks to the BHC Act. **Sec. 603(b)(2)(A) (pp. 227-228)**.

The study also will address eliminating the BHC Act exception for savings associations, which excludes companies controlling a savings association from being regulated as BHCs. ***See* BHC Act § 2(c)(2)(B).** In addition, the GAO study will make specific determinations with regard to the adequacy of the federal bank regulatory framework and the potential consequences of subjecting SLHCs to the BHC Act, including with respect to the availability and allocation of credit, economic stability and safety and soundness of such institutions. **Sec. 603(b)(2)(B) (p. 228)**.

The title requires that the Comptroller General submit the report of the GAO study to the Senate Banking Committee and the House Financial Services Committee within 18 months after the legislation is enacted. **Sec. 603(b)(3) (p. 228)**. This schedule provides Congress 18 months to enact legislation before the end of the moratorium.

B. Reports and Examinations of Holding Companies

1. Reports

The title amends the BHC Act to extend the existing requirement that regulators rely on information provided in externally audited financial statements and publicly available information to the OCC, FDIC, and Fed as supervisors of BHCs. **Sec. 604(a)(2) (p. 229)**. In addition, the Act adds a new BHC Act Section 5(c)(1)(C), extending the existing requirement that any BHC (or subsidiary) promptly provide any of the information described in BHC Act Section 5(c)(1)(B) to any "appropriate Federal banking agency," rather than, currently, the Fed. **Sec. 604(a)(3) (pp. 228-229)**.

2. Examinations

Title VI amends BHC Act Section 5(c)(2) to provide that the Fed is authorized to conduct examinations of the bank holding company (and its subsidiaries) in order to determine the nature of the companies' operations and financial conditions as well as to assess risks within the BHC that may pose a threat to the safety and soundness of the BHC's depository institution subsidiaries or the stability of the U.S. financial system. **Sec. 604(b) (pp. 229-230)**. In doing so, the Fed is directed to "the fullest extent possible" to rely on reports the company has had to file with regulators or examination reports that were made by other federal or state agencies relating the BHC (and its subsidiaries), to use externally audited financial statements, and to coordinate with those other regulators. **Sec. 604(b) (pp. 229-230)**.

The Act amends the Home Owners' Loan Act (12 U.S.C. 1461 *et seq.*) ("HOLA") Section 2 to reflect the transfer of OTS authority, granting the appropriate federal banking agency for a savings and loan holding company authority to conduct examinations of functionally regulated subsidiaries. **Sec. 604(h) (pp. 232-233)**. The Act strikes existing HOLA Section 10(b)(4) relating to examinations. This paragraph provided that each SLHC (and each of its subsidiaries) is subject to examination, the cost of which is to be paid by the holding company, with the Director obligated to use reports filed with or examinations made by other federal or state supervisory authorities to the extent feasible. The amendment substitutes the Fed for the OTS and list the purposes of such examinations, specifically: to inform regulators of the nature of the operations and financial condition of the holding company and its subsidiaries; to inform the Fed of the financial, operational, and other risk within the holding company that may pose a risk to safety and soundness or financial stability; and to inform regulators about the systems the holding company uses to monitor risk, as well as to enforce compliance with federal law. **Sec. 604(h) (pp. 232-233)**.

The new HOLA Section 10(b) preserves the preexisting requirement to use reports made by other Federal and State agencies "to the fullest extent possible" (rather than the previous "to the extent deemed feasible") and requires that the appropriate Federal banking agency coordinate with other regulators with regard to providing reasonable notice before requesting a report and avoiding duplicative examinations. **Sec. 604(h) (pp. 232-233)**.

These provisions are effective as of the transfer date.

C. Increased Fed Authority Over Functionally Regulated Subsidiaries of BHCs

Title VI strikes BHC Act Section 10A, under which the Fed generally could not "prescribe regulations, issue or seek entry of orders, impose restraints, restrictions, guidelines, requirements, safeguards, or standards, or otherwise take action under or pursuant to any provision of [the BHC Act] or Section 8 of the [FDI Act] against or with respect to" a functionally regulated subsidiary. **BHC Act § 10A(a)**. Thus, the Fed was prohibited from issuing regulations or guidance that specifies policies for subsidiaries engaging in regulated activities. At the same time, Section 10A provided two potentially significant exceptions to these prohibitions:

i. <u>The material risk exception</u>, under which the Fed may take supervisory action that "is necessary to prevent or redress an unsafe or unsound practice or breach of fiduciary duty" that poses a material risk to the financial safety, soundness or stability of an affiliated depository institution; or the domestic or international payment system, ***see*** **BHC Act § 10A(a)**; and

ii. <u>The statutory compliance exception</u>, under which the Fed could take supervisory action "to enforce compliance by a functionally regulated subsidiary of a bank holding company with Federal law that the Fed has specific jurisdiction to enforce against such subsidiary," ***see*** **BHC Act § 10A(c)**.

Striking BHC Act Section 10A enhances Fed authority but does not supplant the functional regulators. Title VI will continue limits on the Fed's power with respect to functionally regulated subsidiaries and preserves the role of the agencies primarily responsible for regulating them. Under the title, the Fed would be required to provide notice to and consult with the appropriate federal or state regulatory agency of a functionally regulated subsidiary before requesting a report or commencing an examination of the subsidiary. **Sec. 604(b) (pp. 229-230)**. In addition, Title I, Section 162(b) provides that if the Fed finds a condition, practice, or activity of a functionally regulated subsidiary which does not comply with the Fed's regulations or orders, the Fed may recommend that the primary financial regulatory agency for the subsidiary initiate a supervisory action or enforcement proceeding. **Sec. 162(b) (p. 48)**. The Act provides that if during the 60 days following the date the primary financial regulatory agency receives a recommendation it does not take supervisory or enforcement action against the subsidiary that is "acceptable" to the Fed, the Fed may take the recommended supervisory or enforcement action "as if the subsidiary were a bank holding company subject to supervision by the Board of Governors." **Sec. 162(b)(2) (p. 48)**.

These provisions are effective as of the transfer date.

D. Acquisitions of Banks and Nonbanks under the BHC Act

1. Acquisitions of Banks

Title VI amends BHC Act Section 3(c) to require the Fed to consider whether a proposed acquisition, merger, or consolidation between banks (or a bank and a nonbank) would result in greater or more concentrated risks to the stability of the U.S. banking or financial system. **Sec. 604(d) (p. 230)**.

The new law also provides that, for purposes of BHC Act Section 3, a nonbank financial company supervised by the Fed is deemed to be, and is treated as, a BHC. **Sec. 163(a) (p. 48)**.

2. Acquisitions of Nonbanks

Under the previous BHC Act Section 4(j)(1), a bank holding company must provide the Fed at least 60 days written notice before engaging in any transaction or activity that would cause it to engage in a nonbanking activity. Under Regulation Y, a bank holding company that is well-capitalized and well-managed and that meets certain other criteria can file an after-the-fact notice. BHC Act Section 4(j)(2)(A) currently provides that, in connection with such a notice, the Fed must consider whether the performance of the activity by the BHC can reasonably be expected to produce public benefits that outweigh possible adverse effects.

Title VI amends the BHC Act Section 4(j)(2)(A), to require that the Fed consider the "risk to the stability of the U.S. banking or financial system" as a consequences of a transaction or engaging in an activity. The former criteria were undue concentration of resources, decreased or unfair competition, conflicts of interest, and unsound banking practices. **Sec. 604(e)(1) (pp. 230-231)**.

Title VI also amends BHC Act Section 4(k)(6)(B) to require that a financial holding company receive prior approval from the Fed to acquire a company with total consolidated assets above $25 billion. **Sec. 604(e)(2) (p. 231)**. Such acquisitions would still be subject to antitrust merger review in addition to requiring approval from the Fed. For smaller acquisitions, present law would not change, allowing a financial holding company to engage in activities that are financial in nature and acquire shares in financial companies that engage in financial activities without Fed approval.

In addition, Title VI amends BHC Act Section 4(k)(6)(B) to require prior notice of large acquisitions to the Fed. A BHC with total consolidated assets of $50 billion or more or a NBFC supervised by the Fed would need to provide written notice to the Fed before gaining direct or indirect control over a company engaged in BHC Act Section 4(k) financial activities with total consolidated assets of $10 billion or more. **Sec. 163(b) (pp. 48-49)**.

These provisions are effective as of the transfer date.

E. SLHCs

1. Provision of Information

Title VI amends Section 10(b)(2) of HOLA to apply to SLHCs provisions now applicable to BHCs under Section 5 of the BHC Act. It provides that on request SLHCs must provide the Fed information, but that the Fed is to use existing reports and information from other regulatory agencies to the extent possible. **Sec. 604(g) (pp. 231-232)**. HOLA is also amended to add the same provisions with respect to Fed examinations of SLHCs and their subsidiaries. **Sec. 604(h) (pp. 232-233)**. These provisions is effective as of the transfer date.

2. New Exclusion from SLHC Status

The title adds a new exclusion from the definition of an SLHC for a grandfathered Unitary SLHC—as provided in HOLA Section 10(c)(9)(C) added by the Gramm-Leach-Bliley Act—(a "Unitary") that is required by the Fed to establish an IHC. The exclusion applies to a company described in HOLA Section 10(c)(9)(C) "solely by virtue of" its control of an IHC "established under" new Section 10A of HOLA (See Section 626 below). Under HOLA Section 10A, the Fed must make a determination before an SLHC can establish a qualifying IHC. If the Fed makes that determination, the IHC would be an SLHC and its Unitary parent would cease to be an SLHC. **Sec. 604(i) (p. 233)**. This provision is effective as of the transfer date.

3. Intermediate Holding Companies Under the New HOLA Act

A companion amendment to the exclusion from the definition of SLHC in Section 604(i) is the addition of new Section 10A to HOLA concerning IHCs. Parallel to the Title I IHC provisions, this IHC provision is intended to ensure that nonfinancial activities are not subject to financial regulation. Nothing in Section 10A is to be construed to require a Unitary to "conform its activities to permissible activities" under HOLA. This provision does not specify an effective date; while it therefore is effective as of the Act's enactment, the companion SLHC exclusion provision is not effective until after the transfer date. **Sec. 626 (pp. 268-271)**.

The Fed may require a Unitary to establish an IHC in which to conduct "all or a portion" of its financial activities, not including internal financial activities. The Fed must require a Unitary to establish an IHC if necessary to appropriately supervise activities that are determined to be financial activities, or to ensure that supervision by the Fed does not extend to the activities of such company that are not financial in nature. **Sec. 626 (pp. 268-271)**. It should be noted that the Title I IHC provisions closely parallel these IHC provisions and that a grandfathered SLHC under Title VI might also be a Supervised NBFC and subject to both sets of IHC provisions. House Financial Services Chairman Frank addressed this possibility in a Floor colloquy at the time of the House's final passage of the legislation. He stated that these provisions are intended to be applied "in harmony" so that affected firms will not be subject to inconsistent requirements.

The Fed "may" adopt affiliate transaction rules for IHCs "as necessary to prevent unsafe and unsound practices in connection with transactions between such company, or any subsidiary thereof, and its parent company or affiliates that are not subsidiaries of such company, except that such regulations shall not restrict or limit any transaction in connection with the *bona fide* acquisition or lease by an unaffiliated person of assets, goods, or services." **Sec. 626 (pp. 268-271)**.

A company that directly or indirectly controls such an IHC must serve as a source of strength to its subsidiary IHC. The parent of an IHC may be required to file reports, as the Fed determines, to allow assessment of compliance and ability to serve as a source of strength. The title also states expressly that the parent company will be subject to the enforcement provisions of Section 8 of the FDI Act, as if it were a bank or SLHC. **Sec. 626 (pp. 268-271)**.

F. Oversight of Depository Institutions and Their Subsidiaries' Activities

Title VI adds a new BHC Act Section 26, entitled "Assuring Consistent Oversight of Subsidiaries of Holding Companies." The new section provides for the Fed to examine the activities of a non-depository institution subsidiary of a holding company in the same manner and according to the same standards as if the activities were conducted within the holding company's largest insured depository institution subsidiary. If the Fed fails to conduct such examinations as required by BHC Act Section 26, the OCC or FDIC (whichever agency is responsible for supervising the holding company's largest insured subsidiary) may issue a recommendation to the Fed to conduct such an examination. If the Fed fails to follow the recommendation within 60 days, the OCC or FDIC may conduct its own examination. These provisions seem intended to provide that the same standards applied to a bank's activities, *e.g.*, mortgage lending, will be applied to a similar subsidiary of the holding company (and possibly to relieve the Fed of the need to conduct these exams). Title VI also includes provisions calling for inter-agency coordination when such exams take place. This provision is effective as of the transfer date. **Sec. 605 (pp. 233-234)**.

G. Recommendation and Back-Up Authority

Based on the information collected in such examinations, the FDIC or OCC can submit a recommendation to the Fed that it take enforcement action against a nondepository subsidiary of the depository institution if it determines that the subsidiary's activities pose a material threat to the safety and soundness of any insured depository institution subsidiary of the holding company. If the Fed does not take such recommended enforcement action or provide a plan for enforcement action that is acceptable to the lead federal banking agency within sixty days of receipt of the recommendation, the lead federal banking agency can then take such action as if the subsidiary were an insured depository. This provision is effective as of the transfer date. **Sec. 605 (pp. 233-234)**.

H. Requirement for Financial Holding Companies to Remain Well Capitalized and Well Managed

Title VI amends BHC Act Section 4(l)(1) to require a BHC engaging in any Section 4(k) financial activity to be well capitalized and well managed—in addition to the present requirement that the banks in a financial holding company be well capitalized and well managed. **Sec. 606 (pp. 236)**. Thus, the amendment would extend the well capitalized and well managed requirement from the depository subsidiary to the bank holding company level. This provision is effective as of the transfer date.

I. Regulations Regarding Capital Levels for BHCs and SLHCs

Express language is added to BHC Act Section 5(b) and HOLA to provide that the Fed may establish capital standards by regulation and order. It further specifies that the Fed is to make these requirements countercyclical so that the amount of capital required to be maintained increases in times of economic expansion and decreases in times of economic contraction. This provision is effective as of the transfer date. **Sec. 616(a)-(b) (p. 245)**.

Title VI also amends Section 908 of the International Lending Supervision Act of 1983 to require federal banking agencies to make capital standards countercyclical with respect to insured depository institutions. This provision is effective as of the transfer date. **Sec. 616(c) (p. 245)**.

J. Source of Strength Requirements

Under current Regulation Y, the Fed expects a BHC to "serve as a source of financial and managerial strength" to its affiliated depository institutions. 12 C.F.R. § 225.4(a). Under this policy, the Fed maintains that it may order a BHC, through a capital directive or by other means, such as the sale of a nonbank subsidiary, to provide funds to its subsidiary depository institutions. As a supervisory matter and with applications, the Fed may look with disfavor on capital structures that inhibit a BHC's ability to raise funds. Also, the Fed may object to the issuance of capital or debt instruments to fund the expansion of nonbank operations, if in its opinion, such action may hamper a BHC's future ability to supply needed funds to a depository institution subsidiary.

Title VI adds a "source of strength" requirement to the FDI Act as a new Section 38A.

This section requires that a BHC or SLHC serve as a source of financial strength for its depository institution subsidiary. "Source of financial strength" is defined to mean "the ability of a company that directly or indirectly controls an insured depository institution to provide financial assistance to such insured depository institution in the event of the financial distress of the insured depository institution." Any other company that controls an insured depository institution but is not a bank holding company or savings and loan holding company, would be required to serve as a source of financial strength for it. Such "other companies" could also be required to submit reports on their ability to serve as a source of strength. The federal banking agencies would jointly issue final rules within one year of passage to carry out this new section. **Sec. 616(d) (pp. 245-246)**.

These provisions are effective as of the transfer date. **Sec 616(e) (p. 246)**.

K. Interstate Acquisitions

Title VI amends the BHC Act and the FDI Act to provide that banks engaging in interstate acquisitions be "well capitalized and well managed" rather than the current "adequately capitalized and adequately managed." This provision is effective as of the transfer date. **Sec. 607 (p. 237)**.

L. Interstate Branching

The Riegle-Neal Act is amended to allow national and state banks to establish *de novo* interstate branches at any location where a bank based in that state could establish a branch. This provision is effective on the day following enactment of the Act. **Sec. 613 (p. 243-244)**.

M. Interstate Merger Transactions

Title VI amends the FDI Act, BHC Act, and HOLA, with a provision that the responsible agency may not approve an application for an interstate merger transaction, or an application to acquire an insured depository institution, if the home state of the acquired insured depository institution is different than the home state of the holding company and if the resulting insured depository institution (including all affiliates) would control more than 10% of the total amount of deposits in insured depository institutions in the United States. An exception is made if the merger involves an insured depository institution in default or in danger of default, or for which the FDIC provided assistance under FDI Act Section 13. This provision is effective on the day following enactment of the Act. **Sec. 623 (p. 264-266)**.

N. Enhancing Restrictions on Bank Transitions with Affiliates—Securities Lending and Derivatives Transactions

Title VI would enhance existing restrictions on bank transactions with affiliates by amending FR Act Section 23A(b) to include securities lending and derivative transactions. First, the term "affiliate" is redefined to broadly include "any investment funds with respect to which a member bank or affiliate thereof is an investment advisor," replacing a more complex provision that includes as an affiliate any company that is sponsored or advised on a contractual basis by a member bank or that is an investment company for which a member bank is an investment advisor as defined in the 1940 Act. Affiliates are considered an "investment fund" (*e.g.*, a hedge or private equity fund) even if organized and managed outside the Investment Company and Advisers Act. **Sec. 608(a)(1) (pp. 237-238)**. Significantly, securities lending transactions would be added to the "covered transactions" definition, as are derivative transactions to the extent either type of transaction "causes a member bank or a subsidiary to have credit exposure to the affiliate." It also makes a technical amendment to the definition of "covered transactions" in which the reference to repurchase agreements—defined as "a purchase of assets subject to an agreement to repurchase" —is moved from its current position in a provision relating to the purchase of assets to a provision relating to loans and extensions of credit. **Sec. 608(a)(1) (pp. 237-238)**.

Title VI makes several additional changes which expand the definition of "covered transactions." It expands the Section 23A(c)(1) collateral requirements to include "any credit exposure of a member bank or a subsidiary to an affiliate resulting from a securities borrowing or lending transaction or a derivative transaction . . . ." Also, Title VI expands the Section 23A(c)(1) references to "a letter of credit" to include "letter of credit, or credit exposure" in each case. **Sec. 608(a)(2) (p. 238)**. Consistent with the expansion of the "covered transaction" definition, Title VI amends Section 23A(d)(4) dealing with exceptions to the affiliate transactions rule to add that the section does not apply to "having credit exposure resulting from a securities borrowing or lending transaction, or derivative transaction to" an affiliate that is fully secured by either obligations of the United States that are guaranteed by the United States or a segregated, earmarked deposit account with the member bank. **Sec. 608(a)(3) (p. 238)**.

Further changes are related to the "covered transaction" definition. Title VI, for example, strikes Section 23A(c)(2), currently providing that any collateral subsequently retired or amortized must be replaced by additional collateral where needed to keep the ratio of collateral to outstanding loan value at a minimum level. The new law also amends Section 23A(c)(3) (redesignated as paragraph 2) to add that a low quality asset is not acceptable as collateral for, credit exposure to an affiliate resulting from a securities borrowing or lending transaction. **Sec. 608(a)(2) (p. 238)**.

Note that Title VI also amends Section 23A(f), the rulemaking and additional exemptions provisions, to the following effect:

i. The Fed can no longer exempt transactions or relationships from the affiliate transactions rules "by order" but rather would need to do so "by regulation";

ii. The Board must find any exemption to be in the public interest and consistent with the purposes of the affiliate transactions rules (as it must under current law), as at present. The Act adds the requirement that the FDIC would need to receive notice of the Fed's finding that the exception was in the public interest and "not object, in writing" to the finding within 60 days of receiving notice. **Sec. 608(a)(4) (pp. 238-239)**.

Exemptions will no longer be the sole province of the Board. Rather, the OCC and the

FDIC will have a parallel role with the Board. Specifically, the Comptroller will have the power to exempt a transaction of a national bank from the affiliate transaction rules if the Fed and the Comptroller jointly find the exemption is in the public interest and notify the FDIC. The FDIC must not object in writing to the exemption within 60 days of receiving notice of the proposed exemption. **Sec. 608(a)(4) (pp. 238-239)**. Also, the FDIC will have the authority to exempt transactions of a state bank if the Fed and the FDIC jointly find the exemption is in the public interest and the FDIC finds the exemption does not present an unacceptable risk to the Deposit Insurance Fund. **Sec. 608(a)(4) (pp. 238-239)**.

Title VI amends FR Act Section 23B(e), relating to restrictions on transactions with affiliates and the power of the Fed to issue regulations exempting transactions or relationships from the section. Parallel to the Section 23A exemptions, the Fed will be required to find any exemption or exclusion to be in the public interest and consistent with the section, and also notify the FDIC. The FDIC must not object in writing within 60 days of receiving notice. **Sec. 608(b) (pp. 239-240)**.

Title VI amends HOLA Section 11 to add that the Comptroller could exempt transactions of a Federal savings association if the Fed and the Comptroller jointly find the exemption is in the public interest and the FDIC does not object to the exemption within a 60 day notice period. Similarly, Title VI provides that the FDIC could exempt a state savings association from the requirements of the section if the Fed and the FDIC jointly find the exemption is in the public interest and the exemption does not present an unacceptable risk to the Deposit Insurance Fund. **Sec. 608(c) (p. 240)**.

These provisions are effective one year after the transfer date. **Sec. 608(d) (p. 240)**.

O. Eliminating Section 23A Exceptions for Bank Transactions with Financial Subsidiaries

Section 609 strikes FR Act Section 23A(e)(3) to end the exception for transactions between a bank and a financial subsidiary. **Sec. 609 (p. 241)**. Under the previous FR Act, the restrictions regarding transactions with affiliates did not apply to covered transactions between a bank and any individual financial subsidiary of the bank. The new provision is effective one year after the transfer date.

P. Lending Limits on Credit Exposure on Derivative Transactions, Repurchase Agreements, Reverse Repurchase Agreements, and Securities Lending and Borrowing Transactions

Title VI amends Section 5200 of the Revised Statutes of the United States (12 U.S.C. § 84) controlling loans by member banks to their executive officers, directors, and principal shareholders by specifying that the term "loans and extensions of credit" includes all direct or indirect advances of funds to a person made on the basis of any obligation of that person to repay the funds; any liability of a national banking association to advance funds to or on behalf of a person pursuant to a contractual commitment; and credit exposure to a person arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction or securities borrowing transaction between the national banking association and the person. The provision defines the term "derivative transaction" to include "any transaction that is a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets." This provision is effective one year after the transfer date. **Sec. 610 (p. 241)**. Additionally, Title VI amends FDI Act Section 18 to apply lending limits to derivatives transactions of state banks and is effective 18 months after the transfer date. **Sec. 611 (pp. 241-242)**.

Q. Insider Transactions

Title VI amends FR Act Section 22(h)(9)(D) dealing with extensions of credit to executive officers, directors, and principal shareholders of member banks by expanding the scope of "extension of credit" to include cases where the member bank has credit exposure to a person arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction or securities borrowing transaction. This provision is effective one year after the transfer date. **Sec. 614 (p. 244)**.

In addition, Title VI amends FDI Act Section 18 by inserting a new subsection that would prohibit an insured depository institution from purchasing an asset from or selling an asset to one of its executive officers, directors, or principal shareholders (or any related interest of such person) unless: (1) the transaction is on market terms; and (2) the transaction is approved by the majority of the institution's uninterested directors if the transaction comprises of more than 10% of the institution's capital stock and surplus. The amendment would also empower the Fed to issue rules needed to define terms and carry out the new subsection. This provision is effective on the transfer date. **Sec. 615 (pp. 244-245)**.

R. Conversions of Troubled Banks and Savings Associations

Title VI prohibits conversions of national banks to state banks and state banks to national banks at any time when the banks are subject to enforcement orders including a cease and desist order. This would be accomplished in two ways: first, by amending 12 U.S.C. Section 214 *et seq.* relating to the conversion of national banks to a state bank by inserting a new section that would prohibit conversions to a state bank or state savings association if a national bank is subject to a cease and desist order or other formal enforcement order and, second, by amending 12 U.S.C. Section 35 relating to the conversion of a state bank to a national bank by prohibiting the Comptroller from approving the conversion when the state bank is subject to a cease and desist order or other enforcement order. **Sec. 612(a)-(b) (pp. 241-242)**. Similarly, the Act would amend HOLA Section 5(i) to provide that a federal savings association cannot convert to a national bank or state bank or state savings association if it is subject to a cease and desist order or other formal enforcement order. **Sec. 612(c)(p. 242)**. An exception permits conversion to take place if the agency that would be the appropriate federal banking agency after conversion: (1) notifies the authority that issued the cease and desist order; (2) submits a plan to the authority that issued the order which addressed the problem "in a manner consistent with the safe and sound operation of the institution"; and (3) the authority which issued the order does not object within 30 days. **Sec. 612(d) (pp. 242-243)**.

These provisions are effective on the day following enactment of the law.

S. Elimination of Elective Investment Bank Holding Company Framework

Title VI eliminates the elective investment banking holding company framework, which had allowed the SEC to serve as a "holding company" regulator for such companies as Bear Sterns and Lehman Brothers. The Exchange Act Section 17(i) provided for the elective supervision of an investment bank holding company that does not have a bank or savings association affiliate. This provision allowed an investment bank holding company that is not an affiliate of an insured bank to become supervised as an investment bank holding company by filing a notice of intention with the SEC. Title VI amends the Exchange Act Section 17 by striking subsection (i), eliminating the elective investment bank holding company framework. This provision is effective on the transfer date. **Sec. 617 (p. 246)**.

T. Securities Holding Companies

Title VI provides for the recognition of supervised "securities holding companies." Under the supervision of the Board, these companies would be subject to regulation under FDI Act Section 8(b), (c) through (s), and (u) and under the BHC Act to the same extent as if they were BHCs, except that they are not deemed BHCs for purposes of BHC Act Section 4. **Sec. 618(e) (pp. 249-250)**. The provision defines "securities holding company" to mean an entity that owns or controls one or more registered broker dealers but excludes a NBFC supervised by the Fed, an insured bank (except for those institutions described in BHC Act Sections 2(c)(2)(D), (F), and (H)), an affiliate of an insured bank, and supervised foreign banks. **Sec. 618(a) (pp. 246-247)**.

Title VI provides that a securities holding company subject to comprehensive consolidated supervision under foreign law can register with the Fed to become a supervised securities holding company. The provision also provides that all supervised securities holding companies (and each affiliate) must make and maintain records the Fed determines are needed to monitor compliance. Records required to be kept include balance sheet or income statements, assessments of consolidated capital and liquidity, a report by an independent auditor attesting to compliance, and a report concerning the extent the company has complied with regulations and orders. **Sec. 618(b)-(c) (pp. 247-249)**. Title VI also grants the Fed examination authority over any supervised securities holding company and any affiliate, but requires the Fed to use reports and examinations made by other federal and state regulators to the fullest extent possible. **Sec. 618(c)(3) (p. 248-249)**. The Fed would have authority to prescribe capital adequacy and other risk management standards for supervised securities holding companies, which could be differentiated on an individual basis or by category. **Sec. 618(d) (p. 249)**. These provisions take effect on the day after enactment of the Act.

U. The "Volcker Rule"

1. Overview

The Act contains a version of the "Volcker Rule" (the "Rule")—so named for former Fed Chairman Paul Volcker—that differs in material respects from the version originally introduced from the Senate bill into the House-Senate Conference. As in earlier versions, the Rule invokes Chairman Volcker's core concept of separating certain risk activities from the federal bank subsidy.

In its final form, the Rule follows the approach of the Merkley-Levin Amendment (S.A. 4101) that was introduced into (but not acted on by) the Senate.

As Senators Levin and Merkley explained in their colloquy of July 15, 2010, Sections 619, 620 and 621 of the Act are intended to do three things: prohibit high risk proprietary trading at banks, limit the systemic risk of such activities at systemically significant NBFCs, and prohibit material conflicts of interest in asset-backed securities ("ABS"). Sections 619 and 620, what we refer to herein as the "Volcker Rule," amend the BHC Act. The Senators also explained that Section 619 is intended "to restore the purpose of the Glass-Steagall barrier between commercial and investment banks" and to "update that barrier to reflect the modern financial world and permit a broad array of low-risk, client-oriented financial services."

The provision prohibits a class of defined "banking entities" from engaging in private capital fund investing and proprietary trading and require that regulators apply quantitative limits and capital requirements to any Supervised NBFC that engages in these same activities. "Banking entities" for this purpose include any entity that controls a depository institution and any of its affiliates. A company that is both a banking entity and a Supervised NBFC is subject to the outright prohibition on banking entities engaging in the activities.

The Rule establishes a series of exemptions from these prohibitions, restrictions, and limitations—exemptions that both allow banking entities to participate in the activities and free Supervised NBFCs from otherwise applicable capital requirements and quantitative limits. The Rule also grants considerable discretion to regulators—discretion to clarify very broad core definitions, grant further exemptions, and subject even activities that are "permitted" under the statute to regulations and restrictions. Thus, the true impact of the Rule will not be clear until regulations are written, terms more clearly defined, and exceptions considered and granted.

While there is no doubt the Rule will have a meaningful impact on the extent to which companies benefiting from the federal bank subsidy can engage in risk activities, it is not yet clear where the final lines will be drawn. For example, while "hedge fund" and "private equity fund" are defined to mean any issuer that would be an investment company under the 1940 Act but is excluded from such coverage by the provisions of Sections 3(c)(1) and 3(c)(7), during the colloquy of House Financial Services Chairman Frank and Congressman Jim Himes, Congressman Himes made the point that the intent was not to prohibit investment in subsidiaries or joint ventures that hold investment but rather to "prohibit firms from investing in traditional private equity funds and hedge funds" and Chairman Frank confirmed that "[t]he point the gentleman makes is absolutely correct."[16] The Chairman's statement underscores the task of the regulators to adopt implementing rules that reflect the intent expressed in legislative history when addressing the at times broad statutory language.

The final Rule offers a number of complexities and unresolved issues, as more fully discussed below. However, consider the following core structural elements of the Rule:

i. *Entities Covered*. Prohibitions on proprietary trading and engaging in covered transactions with sponsored hedge funds and private equity funds extends not only to insured depository institutions but also to any company that "controls" an insured depository institution, foreign firms treated as BHCs under the International Banking Act, and any of their affiliates or subsidiaries;

ii. *Council Study*. The Council will conduct a study and make recommendations on implementing the Rule, but unlike some earlier versions of the Rule considered by the Senate, it would not have clear authority to overrule any of the statutory provisions of the Rule;

iii. *Supervised NBFCs*. Only a very narrow set of entities will be Supervised NBFCs subject to the capital requirements and quantitative limits but not within the definition of "banking entities." In fact, in the beginning, there will be no such companies. Companies covered by the limitations will come into

16 Cong. Record, June 30, 2010, p. H5226 (Chairman Frank went on to stated that "We do not want these overdone. We don't want there to be excessive regulation. And the distinction the gentleman draws is very much in this bill, and we are confident that the regulators will appreciate that distinction, maintain it, and we will be there to make sure that they do."). Also, while in the Senate the colloquy of Senators Merkley and Levin on July 15, 2010 discussed that the definition of hedge and private equity fund is "a broad definition," unlike the Frank-Himes colloquy it does not address placing limitations on the definition.

existence only over time. This can happen either as NBFCs are designated for Fed supervision because they are systemically significant (under Section 113 of the Act) or as former BHCs with consolidated assets of $50 billion or more that received federal assistance under the Emergency Economic Stabilization Act of 2008 dispose of their insured depository institution subsidiaries and become Supervised NBFCs (under Section 117 of the Act) — and even then such entities may appeal the designation;

iv. *Exemptions*. Exemptions apply to "permitted activities" that include investments in obligations of the United States and various government sponsored entities, such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home loan Mortgage Corporation ("Freddie Mac"), investments in a small business investment company, and the sponsorship of a hedge or private equity fund for sale to customers that entails a *de minimis* investment by the organizing banking entity;

v. *Broad Regulator Discretion*. Federal banking agencies, the SEC, and the CFTC (collectively the "Regulators") have broad authority to adopt rules imposing additional capital requirements and quantitative limits (as well as diversification requirements) on fund ownership and proprietary trading activities even if these activities are "permitted" and regardless of whether it is a banking entity or a Supervised NBFC that does not control a depository institution engaging in the activity, as well as authority to authorize additional exemptions;

vi. *Affiliate Transactions*. Affiliate transaction rules apply to relationships between banking entities and sponsored funds, with federal agencies required to place limits on the relationships that banks, their affiliates, and BHCs can have with sponsored hedge funds and private equity funds; and

vii. *Foreign Companies*. Prohibitions will not apply to investments or activities conducted by foreign-organized companies whose businesses are conducted outside the United States or companies that do no business inside the United States except that are incidental to their international business, provided the companies are not directly or indirectly controlled by companies organized under U.S. laws.

viii. *Asset-Backed Securities*. While not technically a part of the Rule, Section 621 of the Act is related and is similarly based on language from Senators Merkley and Levin. It prohibits firms that package and sell asset-backed securities (including synthetic ABS) from engaging in transactions that involve or result in material conflicts of interests.

2. Entities Covered

a. "Banking Entities"

"Banking entities" subject to the Rule's prohibitions are defined to mean any insured depository institution (including both banks and thrifts), any company that controls an insured depository institution, or any company treated as a BHC for purposes of Section 8 of the International Banking Act of 1978, and any affiliate or subsidiary of such an entity.[17] Thus, for example, the term includes SLHCs.

However, the term "insured depository institution" is defined not to include any institution that functions solely in a trust or fiduciary capacity if:

i. Substantially all the deposits of the institution are in trust funds and are received in a *bona fide* fiduciary capacity;

ii. No deposits are insured by the FDIC or marketed through an affiliate of an FDIC insured institution;

iii. The institution does not accept demand deposits (or similar deposits); and

iv. The institution does not obtain payment related services from any Federal Reserve bank or exercise discount or borrowing privileges under the FR Act.[18]

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17 Section 8(a) of the International Banking Act of 1978 provides that "(1) any foreign bank that maintains a branch or agency in a State, (2) any foreign bank or foreign company controlling a foreign bank that controls a commercial lending company organized under State law, and (3) any company of which any foreign bank or company referred to in (1) and (2) is a subsidiary shall be subject to the provisions of the Bank Holding Company Act." Thus, while Section 8 of the International Banking Act does not "treat as a bank holding company" such foreign banks, it does "subject" them to the act. Note also that where the Act mentions this provision in other sections it refers specifically to Section "8(a)" rather than to Section 8.

18 In their July 15, 2010 colloquy, Senators Merkley and Levin explained that this is "a narrow exception for insured depository institutions that function principally for trust purposes and do not hold public depository money, make loans, or access Federal

[Footnote continued on next page]

b. Supervised Nonbank Financial Companies

Supervised NBFCs are nonbank financial companies that are determined to be systemically important and therefore subject to Fed supervision. The Act requires that Supervised NBFCs that do not control a depository institution and that engage in covered activities meet additional capital requirements and additional quantitative limits (to be set by the Fed by rule) even though they are not strictly "prohibited" from engaging in such activities. Engaging in proprietary trading and taking an ownership interest in or sponsoring a hedge fund or private equity fund are covered activities. Supervised NBFCs that do not own a depository institution may engage in activities permitted to banking entities under the Rule without these restrictions, except that they must comply with the capital requirements and quantitative limits that the Regulators place on permitted activities "to protect the safety and soundness of banking entities engaged in these activities."[19]

In their colloquy of July 15, 2010, Senators Merkley and Levin explained that Supervised NBFCs are required "to keep additional capital for their proprietary trading activities and subject them to quantitative limits on those activities" in order to account for the additional risks posed by proprietary trading. The Senators also explained that an outright prohibition on proprietary trading was not appropriate for Supervised NBFCs given their "varied nature" but noted that the trading risks are to be addressed through "robust capital charges and quantitative limits that increase with the size, [leverage], interconnectedness, and systemic importance of the business functions of the nonbank financial firm." The Senators also commented that "these restrictions should also help reduce the size and risk of these financial firms."

[Footnote continued from previous page]

Reserve lending or payment services" and commented that these entities could still be considered Supervised NBFCs if they qualify and would then be subject to regulation under the Volcker provisions.

19 The Volcker Rule is set out in Section 619 of the Act. Note that paragraph (a)(2) of Section 619 establishing the obligations of Supervised NBFC refers to paragraph "(d)(3)." This subparagraph refers only to protecting the safety and soundness of "banking entities" but arguably should include protecting the safety and soundness of Supervised NBFCs as well. This may be a candidate for technical amendment.

3. Activities Covered

a. Proprietary Trading

The Rule prohibits a banking entity from engaging in proprietary trading,[20] and requires the Fed to set capital requirements and quantitative limits on a Supervised NBFC that does not control a depository institution that does so. The rules regarding these restrictions and limitations are subject to certain exceptions.

"Proprietary trading" means, with respect to covered entities, "engaging as a principal for the trading account of the banking entity or nonbank financial company supervised by the Federal Reserve in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, any derivative, any contract of sale of a commodity for future delivery, any option on any such security, derivative, or contract, or any other security or financial instrument" that Regulators by rule determine.

In their July 15, 2010 colloquy, Senators Merkley and Levin commented that there are "essentially three key elements to the definition" of proprietary trading: "(1) the firm must be acting 'as a principal,' (2) the trading must be in its 'trading account' or another similar account, and (3) the restrictions apply to the full range of its financial instruments."

"Trading account" means "any account used for acquiring or taking positions in" the listed securities and instruments "principally for the purpose of selling in the near term (or otherwise with the intent to sell in order to profit from short-term price movements)" and otherwise as regulators determine by rule. Senators Merkley and Levin explained in their colloquy of July 15, 2010 that the term "trading account" was adopted over the term "trading book" —a term originally proposed in the Administration's version of the Rule— "to ensure that all types of accounts used for proprietary trading are covered by the section." In fact, in anticipation that some banks may not segregate short-term trading and long-term investments into distinct accounts (and perhaps to encourage them to do so), the Senators commented that "[f]or banking entity subsidiaries that do not maintain a distinction between a trading account and an investment account, all accounts should be presumed to be trading accounts and converted by the restriction."

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20 Insight into why this is a "prohibition" rather than a limitation with regard to banking entities can be gained from the colloquy of Senators Merkley and Levin on July 15, 2010, in which they explain that, given banks' increasing use of leverage and short term funding, Congress was concerned that in environments where liquidity suddenly evaporates and financial firms become insolvent very rapidly, "[n]o amount of capital could provide a sufficient buffer in such situations."

Not all activities that could be considered "proprietary trading" are covered. In their colloquy of July 15, 2010, Senators Merkley and Levin clarified that activities "that may technically fall within the definition of proprietary trading but which are, in fact, safer, client-oriented financial services" are permitted activities. These exceptions are set out as "permitted activities" and are discussed below.

b. Activities Relating to "Hedge Funds" and "Private Equity Funds"

The Rule prohibits a banking entity from acquiring or retaining an equity, partnership, or other ownership interest in, or "sponsoring" a hedge fund or private equity fund. It also requires the Fed to set capital requirements and quantitative limits on the activities of a Supervised NBFC that does not control a depository institution related to such funds. In their colloquy of July 15, 2010, Senators Merkley and Levin position this fund-based prohibition as an extension of the prohibition on proprietary trading, explaining that "if a financial firm were able to structure its proprietary positions simply as an investment in a hedge fund or private equity fund, the prohibition on proprietary trading would be easily avoided, and the risks to the firm and its subsidiaries and affiliates would continue." The fund ownership and sponsorship prohibition is subject to certain exceptions.

"Sponsor" is defined broadly (as it was in previous iterations of the Act) to include serving as a general partner, managing member, or trustee of a fund; controlling a majority of the directors, trustees or management of a fund; or sharing with the fund for any purpose the same (or a very similar) name.

"Hedge fund" and "private equity fund" have a common definition: all issuers that are exempt from being considered investment companies under the 1940 Act by virtue of Section 3(c)(1) or Section 3(c)(7) of that Act,[21] as well as to "such similar funds" as the Regulators by rule determine. As Senators Merkley and Levin note in their July 15, 2010 colloquy, while hedge funds tend to be trading vehicles and private equity funds tend to own entire companies, the Rule's provisions do not distinguish between them for definitional purposes because "both types of funds can engage in high risk activities." The joint definition is very broad and could be interpreted to apply to many structures that would not be commonly considered hedge funds and private equity funds even under the broadest commonly understood meanings and even though Congress may not have intended such an expansive result.

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21 Section 3(c)(1) of the 1940 Act exempts from being an investment company an issuer whose outstanding securities are beneficially owned by not more than 100 people and that does not make a public offering of its securities. Section 3(c)(7) exempts an issuer whose outstanding securities are owned by persons who are qualified purchasers and does not make a public offering of its securities.

4. Permitted Activities

Banking entities are permitted to engage in ten categories of activity described in the Act that, as explained by Senators Merkley and Levin in their July 15, 2010 colloquy, "do not pose unreasonable risks." In addition, a Supervised NBFC that does not control a depository institution may engage in these "permitted activities" without being subject to additional capital requirements or quantitative limits. If otherwise allowed by federal and state law, and if the Regulators do not set restrictions or limits on these activities, then the following ten categories of activities are permitted:

i. *Trading in Government Securities*. Transactions in obligations of the United States or any agency of the United States, or any instruments issued by the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation, or a federally chartered Farm Credit System institution, or obligations of any state or a political division of any state;

ii. *Underwriting and Market-Making-Related Activities*. The purchase or sale of securities described in the definition of "proprietary trading" that is "in connection with an underwriting or market-making-related[22] activities" to the extent that such activities "are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties"[23];

iii. *Trading for Risk Mitigation*. Risk mitigating hedging activities in

22 The term "market-making-related" activities was substituted into the final version of the Act instead of the previous term "market-making" activities, according to Senators Merkley and Levin in their July 15, 2010 colloquy, in order to "permit certain legitimate client-oriented services, such as pre-market-making accumulation of small positions that might not rise to the level of fully 'market making' in a security or financial instrument, but are intended to nonetheless meet expected near term client liquidity needs" and the term is intended to "provide the regulators with limited additional flexibility to incorporate those types of transactions to meet client needs" but not without limits.

23 In their July 15, 2010 colloquy, Senators Merkley and Levin urge that "'[v]igorous' and robust regulatory oversight of this issue will be essential to prevent market-making from being used as a loophole in the ban on proprietary trading."

connection with holdings of the banking entity that are designed to reduce risks to the banking entity;

iv. *Trading for Customers*. The purchase, sale or disposition of securities described in the definition of "proprietary trading" (that is, any security, derivative, commodities futures contract, option, derivative, or other security or financial instrument that Regulators determine) that are "on behalf of customers";

v. *Small Business Investment Company Investing*. Investments in "small business investment companies," investments designed primarily to promote the public welfare of the type permitted in paragraph (11) of Section 5136 of the United States Code, or (and this final point was added by the House conferees during the final House-Senate Conference session) investments that are qualified rehabilitation expenditures on qualified historic structures;

vi. *Insurance Company Trading*. The purchase, sale or disposition of securities in the definition of "proprietary trading" by a regulated insurance company (or an affiliate) for the general account of the company if the transaction is conducted in compliance with insurance company investment laws and the appropriate Federal banking agencies, after consulting with the Council and other regulators, have not determined that the insurance company investment law being relied upon is insufficient to protect safety and soundness of the banking entity or of U.S. financial stability;

vii. *Fund Offering as Investment Advisor/Fiduciary*.[24] Organizing and offering a private equity fund or hedge fund (including serving as a general partner or controlling a majority of directors or management) if:

A) The banking entity provides *bona fide* trust, fiduciary, or investment advisory services;

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24 In their July 15, 2010, colloquy, Senators Merkley and Levin point out that "[i]t is important to remember that nothing in section 619 otherwise prohibits a bank from serving as an investment adviser to an independent hedge fund or private equity fund" and explain that this exception sets out the criteria that must be met in order for a bank to do so.

B) The fund is organized and offered only in connection with the provision of *bona fide* trust, fiduciary, or investment advisory services only to customers of such services of the banking entity; and

C) The banking entity acquires only a *de minimis* investment;

(1) A "*de minimis* investment" is defined to be no more than 3% of a single fund's total ownership interest within a transition period of one to three years.

(2) A second element of the *de minimis* requirement is that all investments in hedge funds and private equity funds in the aggregate be "immaterial to the banking entity," which will be defined by rule but may by statute be no more than 3% of the banking entity's tier 1 capital.

(3) Also, note that the scope of this provision will not be clear until the terms "trust, fiduciary or investment advisory services" and "customers" are defined by regulation.

D) The banking entity complies with the restrictions on affiliate transactions with any fund it sponsors consistent with Sections 23A and 23B of the FR Act;

E) The banking entity does not guarantee, assume, or insure the obligations or performance of the fund, or any fund in which such fund invests;

F) The banking entity does not share the same name (or a variation of the name) with the fund for corporate, marketing, promotional, or any other purpose;

G) No director or employee of the banking entity takes or retains an ownership interest in the fund (except one that is "directly engaged in providing investment advisory or other services" to the fund); and

H) The banking entity discloses to investors in writing that losses in the fund are borne solely by investors in the fund and not by the banking entity, and complies with rules designed to ensure that losses in the fund are not in fact borne by the banking entity.

viii. Outside the United States;

A) *Proprietary Trading*. Proprietary trading conducted by a banking entity pursuant to paragraph (9) and (13) of Section 4(c) of the BHC Act provided the trading occurs solely outside of the United States and the banking entity is not controlled (either directly or indirectly) by a banking entity organized under the laws of the United States;

B) Paragraph (9) of Section 4(c) of the BHC Act exempts from the restrictions on a bank holding company owning or controlling a nonbanking organization a "company organized under the laws of a foreign country the greater part of whose business is conducted outside the United States, if the Board by regulation or order determines that, under the circumstances and subject to the conditions set forth in the regulation or order, the exemption would not be substantially at variance with the purposes of [the BHC Act] and would be in the public interest";

C) Paragraph (13) of Section 4(c) of the BHC Act exempts from the restrictions on a bank holding company owning or controlling a nonbanking organization a "company which does no business in the United States except as an incident to its international or foreign business, if the Board by regulation or order determines that, under the circumstances and subject to the conditions set forth in the regulation or order, the exemption would not be substantially at variance with the purposes of [the BHC Act] and would be in the public interest."

D) *Fund Investing*. The acquisition or retention of an ownership interest in a hedge fund or private equity fund by a banking entity pursuant to paragraph (9) or (13) of Section 4(c) of the BHC Act solely outside of the United States provided no ownership interest in the fund is offered to residents of the United States and the banking entity is not controlled (directly or indirectly) by a banking entity organized under the laws of the United States; and

ix. *Other Activities*. Other activities the Regulators determine by rule would promote safety and soundness of the banking entity and U.S. financial stability.

5. Limits on Permitted Activities

a. "Permitted activities" are not allowed under all circumstances.

An activity that is "permitted" is still not allowed if the activity:

i. Would result in a "material" conflict of interest (as will be defined by rule) between the banking entity and its clients or counterparties;

ii. Would result (directly or indirectly) in a "material" exposure (as will be defined by rule) by the banking entity to high-risk assets or trading strategies;

iii. Would pose a threat to safety and soundness of the banking entity; or

iv. Would pose a threat to the financial stability of the United States.

b. Capital and Quantitative Limits on Permitted Activities

The Regulators are required to adopt rules that impose additional capital requirements and quantitative limits (including diversification requirements) on "permitted activities" engaged in by either banking entities or Supervised NBFCs if the regulators determine these limitations are appropriate to protect safety and soundness of the entities engaged in the "permitted activities." Thus, even if an activity is permitted and not otherwise subject to limitations, if the Regulators elect to set limits they may do so. Senators Merkley and Levin explained in their July 15, 2010 colloquy that regulators have the discretion to determine whether these restrictions should apply to banking entities and Supervised NBFCs equally or "whether there may appropriately be a distinction."[25]

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25 Senators Merkley and Levin also read in this provision a mandate for regulators to require diversification—specifically, that banking entities should be prohibited from

[Footnote continued on next page]

6. Permitted *De Minimis* Investments in Funds

Notwithstanding the general restriction on banking entities owning private equity and hedge funds, a banking entity can make and retain an investment in a hedge fund or private equity fund that it "organizes and offers" for the purpose of establishing the fund and providing it with sufficient initial equity to permit the fund to attract unaffiliated investors. Several conditions must be met to utilize this provision:

i. The banking entity must seek unaffiliated investors to reduce or dilute its own interest;

ii. The investments in the fund must be reduced through redemption, sale, or dilution to no more than 3% of the total ownership interest in the fund within a year of the date the banking entity establishes the fund (which deadline the Fed has the authority to extend upon the application of the banking entity for up to 2 additional years); and

iii. The investment in the fund must be "immaterial to the banking entity," as will be defined by rule.[26] However, note that under the statute an investment in a fund will not be considered "immaterial" if it causes the aggregate of all interests a banking entity holds in all hedge funds and private equity funds to exceed 3% of the banking entity's own tier 1 capital.[27]

[Footnote continued from previous page]

deploying "their entire permitted amount of de minimis investments into a small number of hedge funds and private equity funds" resulting in over-concentration.

26 In their colloquy of July 15, 2010, Senators Merkley and Levin threw some light on their intention with regard to this requirement, stating that "[a]s a general rule, firms taking advantage of this provision should maintain only small seed funds, likely to be $5 to $10 million or less" and further explaining that "[l]arge funds or funds that are not effectively marketed to investors would be evasions of the restrictions of this section".

27 The Senate substituted "tier 1 capital" for the previous "tangible common equity" during the final hours of the House-Senate Conference. Tier 1 capital generally includes common shares, preferred shares, and deferred tax assets whereas tangible common equity, a less commonly used measure, includes only common shares. Thus, the late Senate switch should, all else being equal, allow for expanded investment by smaller banking entities and those employing preferred shares in their capital structures.

A plain reading of this provision suggests that meeting the *de minimis* requirements alone is sufficient to let a banking entity organize and offer a fund and continue to hold a small investment in that fund. However, a colloquy by Senators Merkley, Levin, and Dodd on July 15, 2010 states that these *de minimis* provisions "complement" the "permitted activity" exception allowing an entity to organize and offer a fund only in connection with the provision of *bona fide* trust, fiduciary, or investment advisory services to customers. Thus, there is an open question as to whether an entity would need to provide "trust, fiduciary or investment advisory" services to the fund (and meet other conditions of that "permitted activity" exception) in order to avail itself of the *de minimis* exception. Note, for example, that while the "permitted activity" exception for offering a fund in connection with trust, fiduciary, or investment advisory services references the *de minimis* standard, there is no reference in the "*de minimis*" provision back to any of the earlier "permitted activities" exceptions.[28]

As commented above, a banking entity can apply to the Fed to extend for 2 additional years the time it has to reduce its ownership in a fund to 3% of the total ownership interest in the fund.[29]

The *de minimis* provision also contains a final subparagraph providing that the aggregate amount of the outstanding investment by a banking entity, including retained earnings, must be deducted from the assets and tangible equity of the banking entity, and that the amount of the deduction must increase with the leverage of the hedge or private equity fund.[30]

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28 The relationship between paragraph (d)(4) and subparagraph (d)(1)(G) of Section 619 will need to be resolved through rulemaking. In the interim, a conservative approach would be to presume that the requirements of both provisions must be met (i.e., that a fund must be offered as a trust or investment advisory service to customers, not share a common name with the offeror, and that the offeror may not guaranty the fund, PLUS that the investment must be reduced to no more than 3% of fund equity within 1-3 years and that the aggregate of all fund investments must not exceed 3% of the offeror's tier 1 capital).

29 There appears to be a minor error in this provision in that it refers to subparagraph "(B)(i)(I)" when subparagraph "(B)(ii)(I)" was clearly intended.

30 In their colloquy of July 15, 2010, Senators Merkley and Levin explain that this provision requires that "investments in hedge funds and private equity funds shall be deducted on, at a minimum, a one to one basis from capital" and that "[a]s the leverage of a fund increases, the capital charges shall be increased to reflect the greater risk of loss." The Senators go on to explain that "[t]his is specifically intended to discourage these high-risk

[Footnote continued on next page]

7. Anti-Evasion

The Regulators are required to issue regulations requiring internal controls and recordkeeping to insure compliance with the Rule. If the Regulators have reasonable cause to believe a banking entity or Supervised NBFC has made an investment or engaged in an activity that "functions as an evasion of the requirements of" the Rule "or otherwise violates the restrictions of" the Rule, then they must order, after notice and opportunity for hearing, the banking entity or Supervised NBFC to terminate the activity and (as relevant) dispose of the investment.

8. Affiliate Transaction Rules Applied to Advised, Managed or Sponsored Funds

Section 23A Applied. No banking entity that serves, directly or indirectly, as the investment manager, advisor, or sponsor of a hedge fund or private equity fund or that organizes and offers a fund (or any affiliate of such a company) may enter into a transaction with the fund (or any fund controlled by the fund) which transaction is a "covered transaction" under Section 23A of the FR Act.

Exempted Activities Covered. Note that Section 23A applies to relationships between banking entities and the funds they organize and offer even if this is done in connection with *bona fide* trust, fiduciary, or investment advisory services even though organizing such funds is otherwise exempt from the Rule prohibitions.

Section 23B Applied. A banking entity will also be subject to Section 23B of the FR Act as if the banking entity were a member bank and the fund were an affiliate. Among other things, this means that transactions must be on terms substantially the same (or at least as favorable) as those prevailing for comparable transactions with nonaffiliated companies.

Affiliates Not Covered. Note the Section 23B restrictions do not expressly apply to transactions between a fund and affiliates of the banking entity.

9. Exception for Prime Brokerage Transactions with Funds

Notwithstanding the restrictions on affiliate transactions, the Fed may permit a banking

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[Footnote continued from previous page]

investments, and should be used to limit these investments to the size only necessary to facilitate asset management businesses for clients."

entity or a Supervised NBFC to enter into a "prime brokerage transaction"[31] with any hedge fund or private equity fund in which another hedge fund or private equity fund managed, sponsored, or advised by it has taken an equity, partnership, or other ownership interest (but the Rule does not allow a banking entity or Supervised NBFC to engage in prime brokerage transactions with a hedge fund or private equity fund that it directly manages, sponsors, or advises)[32] if:

i. The banking entity or Supervised NBFC is in compliance with the requirements for organizing and offering a private equity or hedge fund;

ii. The CEO (or equivalent) of the banking entity certifies in writing annually that it does not guarantee the obligations of any fund it organizes, offers, or controls;

iii. The Fed has determined that the transaction is consistent with the safe and sound operation and condition of the banking entity or Supervised NBFC. Note, however, that it is unclear how the Fed is to make this determination, whether by rule or otherwise; and

iv. The transaction complies with the requirements of 23B as if the counterparty were an affiliate of the banking entity.

10. Additional Capital Charges and Restrictions on Supervised NBFCs Not Controlling a Depository Institution

Supervised NBFCs that do not control a depository institution are not subject to the prohibition on proprietary trading or sponsoring or investing in hedge funds or private equity

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31 The term "prime brokerage transaction" is not defined in the Act. The related term "prime brokerage services" is considered a generic term for a bundle of services provided to hedge funds and professional investors that require the ability to borrow securities and capital and be able to invest on a net basis, and in which the "prime broker" generally provides a centralized securities clearing facility in which a fund's or investor's collateral requirements are netted across all transactions handled by that prime broker.

32 In their July 15, 2010 colloquy, Senators Merkley and Levin explained that this provision is intended to allow a banking entity to provide "limited services to unaffiliated funds, but in which its own advised fund may invest" and that it therefore "is intended to only cover third party funds" with no tolerance for tiered structures designed to evade the affiliate transactions restrictions.

funds. Nevertheless, the Regulators must adopt rules imposing additional capital requirements and other restrictions on Supervised NBFCs that do not control a depository institution as follows:

i. *General Restrictions*. Supervised NBFCs that do not control a depository institution engaging in proprietary trading or sponsoring or investing in hedge funds or private equity funds must generally meet additional capital requirements and quantitative limits even though they are not "prohibited" from engaging in these activities; and

ii. *Affiliate Transaction and Prime Brokerage Restrictions*. Additional capital charges or other restrictions must be placed on Supervised NBFCs that engage in the kinds of affiliate transactions and prime brokerage transactions described above (in the context of banking entities) "to address the risks to and conflicts of interest of banking entities."[33]

11. Rules of Construction

The prohibitions and restrictions of the Rule apply even if the activities of a banking entity or a Supervised NBFC are approved by the Fed. Nothing in the Rule limits the ability of a banking entity or Supervised NBFC to sell or securitize loans. Nothing in the Rule limits the authority of any regulator under applicable law.

12. Timeline

Council Study: Within 6 months of enactment the Council must study and make recommendations on implementing the Rule.

Rulemaking: Within 9 months of the completion of the study the Regulators and the Fed[34] must consider the study and adopt regulations to carry out the Rule. Note that the Fed is to

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33 It is unclear why this provision refers to "banking entities" when it concerns the activities of Supervised NBFCs. It may reflects that the 23A and 23B limits apply only to banking entities and not to Supervised NBFCs. However, because additional capital charges and other restrictions are to be applied to Supervised NBFCs to address 23A and 23B concerns, the wording may need to be changed in a technical amendment.

34 The primary financial regulatory agencies are to jointly issue rules with respect to insured depository institutions. The Fed is to do so with respect to any company that controls an

[Footnote continued on next page]

issue regulations with respect to any company that controls an insured depository or that is "treated as a bank holding company" for purposes of the International Banking Act, for any Supervised NBFC, and any of their subsidiaries. The agencies writing the Rules are required to consult and coordinate with the Chairperson of the Council coordinating regulations to provide consistent application.[35]

Rules must include:

i. Regulations implementing the permitted transactions provisions and any limitations on permitted transactions;

ii. Regulations imposing additional capital requirements and quantitative limits (including diversification requirements) on permitted activities if the Regulators determine these limitations are appropriate to protect safety and soundness of banking entities engaged in permitted activities;

iii. Regulations setting the ownership level in a fund that is "immaterial to the banking entity" which in any event cannot be more than 3% of the banking entity's own tier 1 capital;

iv. Regulations regarding internal controls and recordkeeping to insure compliance with the Rule;

v. Rules determining what "similar funds" are to be included in the definition of "hedge fund" and "private equity fund";

vi. Rules defining the full extent of the definition of "trading account"

[Footnote continued from previous page]

insured depository institution or that is treated as a BHC for purposes of Section 8 of the International Banking Act, any Supervised NBFC, and any of their subsidiaries other than subsidiaries of which another agency is the primary financial regulatory agency issuing rules. The CFTC and SEC are to issue rules with respect to entities for which they are the primary financial regulatory agency.

35 The effective date for the Rule keys off of the date final rules are issued. However, as noted above, multiple agencies will be issuing rules. While the statute requires that these agencies coordinate for "consistency and comparability" there is no requirement that the agencies issue rules on the same date. If the agencies don't issue their rules simultaneously there may be confusion regarding the effective date, or multiple effective dates may result for different classes of regulated entities.

for purposes of purposes of determining the scope of prohibitions on proprietary trading;

vii. Rules defining additional securities that, if traded by a covered entity as a principal for its own trading account, constitute proprietary trading; and

viii. Rules defining additional accounts that count as "trading accounts" for purposes of determining the scope of the prohibition on proprietary trading.

Effective Date: The rule takes effect on the earlier of (i) 12 months after the issuance of final rules or (ii) 2 years after enactment of the Rule. Thus, if the study and rulemaking take their full 15 months, then the section goes effective just 9 months after the issuance of final rules.

Divestiture: Banking entities and Supervised NBFCs must divest to bring their activities in compliance with the Rule within 2 years of the effective date or 2 years (in the case of a new Supervised NBFC) after the date the entity becomes a Supervised NBFC. The Fed can extend this period 1 year at a time (if determined not to be detrimental to the public interest) for a total of 3 additional years. This means that divestiture could be extended out a total of 7 years after the date of enactment—2 years for the effective date plus an initial 2 year transition period plus three additional single year extensions.

Within 6 months of enactment the Fed must issue the rules that will implement this divestiture provision.

Extension for Illiquid Funds: If a banking entity had a contract in place as of 5/1/10 obligating it to retain an interest in or provide capital to an illiquid fund,[36] then it can petition the Fed for an extension of the transition period. The Fed can grant a single extension of not more than 5 years. The most likely interpretation for this provision is that the maximum time for divestiture could be as long as 9 years after the date of enactment—based on the single 5 year extension being a substitute for the otherwise available three single year extensions. However, note that if it were interpreted that this extension is available in addition to the three one-year extensions allowed for regular divestitures, then the transition period could be extended to as long as 12 years after enactment (note that, in favor of arguing for the consecutive interpretation,

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36 "Illiquid fund" is a defined term in the section and means a hedge or private equity fund that, as of May 1, 2010 was principally invested in, or was invested and contractually committed to principally invest in, illiquid assets and that makes all investments consistent with an investment strategy to principally invest in illiquid assets.

the three 1 year extensions can be granted by the Fed "by rule" and are considered part of the "conformance period" in contrast to the "extended transition for illiquid funds" period that can only be granted by the Fed upon application). Regardless of this interpretive issue, however, if the contractual obligation to invest in the illiquid fund terminates before the end of the extension period then the banking entity must immediately exit the investment.

Within 6 months of enactment the Fed must issues rules that will implement the extension provision for illiquid funds.

Limits on Additional Capital: Notwithstanding that divestiture is not required until 2 years after the effective date (at earliest) on the date rules are issued (9 months after the study is completed, or at most 15 months after enactment), the Regulators are required to issue rules imposing additional capital requirements and "any other restrictions, as appropriate, on any equity, partnership, or ownership interest in or sponsorship of a hedge fund or private equity fund by a banking entity." <u>Thus, even before divestiture is required there likely will be additional requirements and restrictions placed on ownership by a banking entity.</u>

13. Studies

a. Council Study and Rulemaking

The Council must conduct a study and make recommendations on rules implementing the section within 6 months of enactment. This is a critical study because it will set the tone for the rulemaking by Regulators. Many of the timeline dates also key off of when the study and recommendations are completed. The Council is to recommend measure that would:

i. Promote the safety and soundness of banking entities;

ii. Protect taxpayers, consumers, enhance financial stability, and reduce risk that depository institutions and their affiliates will engage in unsafe activities;

iii. Limit inappropriate transfer of federal subsidies (i.e., deposit insurance);

iv. Reduce conflicts of interest between banking entities and Supervised NBFCs and their customers;

v. Limit activities that have cause undue risk of loss or "that might reasonably be expected to create undue risk of loss";

vi. Accommodate the business of insurance wile protecting safety and soundness of any banking entity with which an insurance company is affiliated; and

vii. "Appropriately time the divestiture of illiquid assets."

b. Study of Bank Investment Activities

Section 620 (renumbered in the House-Senate Conference but still related to the Rule) requires a second study for completion within 18 months of enactment under which the appropriate federal banking agencies are required to jointly review and report on the activities a banking entity may engage in under federal and state law. The report is to include recommendations on the potential negative effect of banking activities on safety and soundness of the U.S. financial system, the appropriateness of such activities, and any additional restrictions that may be needed to address safety and soundness.

V. Prohibition on Conflicts of Interest in Certain Securitizations

While not technically a part of the Rule, a late House-Senate Conference addition to Act was Section 621 addressing conflicts of interest relating to securitizations of ABS. The provision prohibits an underwriter, placement agent, sponsor, or initial purchaser (or any affiliate or subsidiary) from engaging in a transaction that would involve or result in a material conflict of interest with an investor for 1 year after the initial closing of the sale of an ABS (including a synthetic). Exceptions include transactions that are risk mitigating hedging activities designed to reduce specific risks relating to the initial sale and transactions in ABS that are consistent with the commitments of the underwriter, placement agent, sponsor, or initial purchaser (as applicable), or that are *bona fide* market making activities.

W. Conflicts of Interest

Title VI amends the 1933 Act to add a Section 27B, prohibiting conflicts of interest relating to securitizations. The provision prohibits an underwriter, placement agent, or sponsor of an ABS, within a year after the date of the first sale of the ABS, from engaging in transactions that would "result in any material conflict of interest with respect to any investor." Several exceptions to the prohibition, including relating to risk-mitigating hedging activities, underwriting, and market making, are described. This provision is effective on the date final rules are issued by the SEC, which, in any event, must be within 270 days of the date of enactment of the Act. **Sec. 621 (pp. 261-262)**.

X. Concentration Limits on Large Financial Firms

Title VI amends the BHC Act by adding a new Section 13 titled "Concentration Limits on Large Financial Firms" that would place a concentration limit on large financial firms such that, subject to recommendations by the Council, a financial company may not merge or consolidate with, acquire all or substantially all of the assets of, or otherwise acquire control of another company if the total consolidated liabilities of the acquiring financial company would exceed 10% of the aggregate consolidated liabilities of all financial companies at the end of the year, as a result of the transaction. This limit will not, however, apply to an acquisition of a bank in default or in danger of default, or transactions for which the FDIC provides assistance, or those that would result only in a *de minimis* increase in liabilities. **Sec. 622 (p. 262-264)**.

This provision is effective on the day after enactment of the Act, but implementing rules may not be issued for as long as 15 months following the effective date. The Council is to complete a study of concentration limits within 6 months of the Act's enactment, and the Fed has an additional 9 months following completion of this study to issue implementing rules. **Sec. 622 (pp. 262-264)**.

Y. Qualified Thrift Lenders

Title VI amends HOLA Section 10(m)(3) to require that a savings association that fails to become or remain a qualified thrift lender will immediately be subject to restrictions, including a restriction that the association may not pay dividends except for dividends that would be permissible for a national bank, that are necessary to meet the obligations of the company that controls the savings association, and are specifically approved 30 days before payment by the Comptroller and the Fed after a written request. This provision is effective the day after the Act's enactment. **Sec. 624 (p. 266)**.

Z. Treatment of Dividends by Certain Mutual Holding Companies

Title VI amends Section 10(o) of HOLA's treatment of dividends, requiring that each subsidiary of a mutual holding company that is a savings association give the appropriate federal banking agency and the Fed 30 days' notice of any proposed declaration of any dividend on the guaranty, permanent, or other non-withdrawable stock of the savings association. Any dividends granted without notice will be invalid. Further, a mutual holding company may waive the right to dividends if no employee stock benefit program or insider holds any shares of applicable stock, or if the company gives written notice to the Fed 30 days before the proposed date of dividend payment and the Fed does not object. This provision is effective as of the transfer date. **Sec. 625 (pp. 267-268)**.

AA. Interest-Bearing Transaction Accounts Authorized

The prohibition on payment of interest on demand deposits is repealed by amending Section 19(i) of the FR Act, Section 5(b)(1)(B) of HOLA, and Section 18(g) of the FDI Act. These amendments will take effect one year after the transfer date. **Sec. 627 (pp. 270-271)**.

BB. Credit Card Bank Small Business Lending

Title VI authorizes small business credit card lending for credit card banks. It amends BHC Act Section 2(c)(2)(F)(v) to read "other than credit card loans that are made to businesses that meet criteria for a small business concern to be eligible for business loans" under regulations established by the Small Business Administration. This provision is effective on the day after the Act is enacted. **Sec. 628 (p. 271)**.

TITLE VII: Wall Street Transparency and Accountability

Throughout the financial regulatory reform debate, designing a regulatory framework for the derivatives market has been one of the most contentious issues. While the business community has supported bringing transparency, accountability, and stability to the market, it has been concerned that Congress and regulators could impose burdens on derivatives trading that would disincentivize businesses from hedging their own risks. The derivatives title in the conference report, passed by the Senate on July 15, 2010, is generally opposed by business groups as applying many of the same costs and requirements on end-users as will be applied to swap dealers. How much the final position will burden companies depends largely on the implementation of the law by regulators.

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act establishes a regulatory structure for derivatives. The title requires banks to spin off certain swaps-dealing activities determined by Congress to not constitute "*bona fide* hedging and traditional bank activities." It effectively requires derivative contracts that can be cleared, to be cleared—and exchange-traded. The title provides a narrow exemption for derivatives end users from the clearing and exchange trading requirements, but does not exempt end users from margin requirements. The title requires regulators to set minimum capital requirements and minimum initial and variation margin requirements. While, as noted, end users will not be exempt from the bill's margin requirements, Senators Dodd and Lincoln have written a letter to Representatives Frank and Peterson clarifying that the bill was not intended to impose margin requirements directly on end users. This, of course, does not mean costs will not be passed on to end-users from their counterparties. The title grandfathers existing contracts for purposes of the clearing provision, but not from margin requirements

The title gives the CFTC and SEC one year to implement most of the required rulemaking and regulations.

The following summary addresses the final Dodd-Frank language.[37]

A. Regulation of Over-the-Counter Swaps Markets—Regulatory Authority

1. Short Title

The short title is the "Wall Street Transparency and Accountability Act of 2010." **Sec.**

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37 For ease of reference, the term "[security-based] swap" refers to security-based swaps and non security-based swaps. The "relevant Commission" for swaps is the CFTC, and for non-security-based security-based swaps is the SEC.

701 (p. 271).

B. Regulatory Authority

The CFTC and SEC each must prescribe regulations necessary to carry out the title in consultation and coordination with each other and taking into consideration the views of the prudential regulators. Regulations must be issued not later than 360 days after enactment. Regulations must treat functionally or economically similar products in a similar manner. The CFTC and SEC, after consultation with the Fed, must prescribe joint regulations for mixed swaps. If either Commission objects to a regulation, the Commission may appeal the regulation to the United States Court of Appeals for the District of Columbia Circuit within 60 days after the regulation's publication. **Sec. 712(a)-(c) (pp. 271-274)**.

The SEC, CFTC, and the Fed must jointly make rules governing the books and records that must be kept regarding security-based swap agreements by registered swap data repositories. If the regulators fail to jointly prescribe rules in a timely manner, the Council will resolve the dispute at the request of either Commission. **Sec. 712(d) (pp. 274-276)**.

The title provides that unless otherwise specified, the SEC and CFTC must promulgate rules and regulations separately, not jointly, and the rules and regulations required of each Commission must be promulgated no later than 360 days after the enactment date. **Sec. 712(e) (p. 276)**.

The title provides that a broker or dealer registered with the SEC and registered with the CFTC as a futures commission merchant may hold cash and securities in a portfolio margining account carried as a futures account or a securities account. **Sec. 713 (pp. 276-77)**.

The 360 day time frame for issuing regulations represents a significant improvement from the House and Senate bills, which would have required regulations to be issued within 210 days or 180 days, respectively. Previous versions of the Act also included emergency authority for the SEC and CFTC to promulgate their rules and regulations, which would allow them to bypass the notice and comment periods. CFTC and SEC staff members, however, have stated publicly that they are eager to have the public's input on their rules and regulations.

C. Abusive Swaps

The CFTC or SEC may collect information regarding the markets for any types of [security-based] swap and issue a report with respect to any type of [security-based] swap that the CFTC or SEC determines to be detrimental to the stability of a financial market or participants in a market. **Sec. 714 (p. 277)**.

D. Authority to Prohibit Participation in Swap Activities

If the CFTC or SEC determines that a foreign company's regulation of [security-based] swaps undermine the U.S. financial system stability, then either Commission, in consultation with the Secretary, may prohibit an entity domiciled in the foreign country from participating in the United States in any [security-based] swap activity. **Sec. 715 (p. 278)**.

E. Prohibition Against Federal Government Bailout of Swaps Entities (Swap Desk Spin-Off Provision)

No federal assistance may be provided to any swaps entity with respect to any [security-based] swap or activity of the swaps entity. "Federal assistance" includes the use of any funds, including advances from any Fed credit facility or discount window, FDIC insurance, or guarantees for the purpose of making a loan to or purchasing stock in a swaps entity, purchase any swaps entity's assets, or guaranteeing their debt.

"Swaps entities" include [security-based] swaps dealers, major [security-based] swap participants, swap execution facilities, designated contract markets, national securities exchanges, central counterparties, clearing houses, clearing agencies, and registered derivatives clearing organizations. The term specifically excludes any major swap participant ("MSP") that is an insured depository institution and any insured depository institution or Title II CFC which is in conservatorship, receivership, or a bridge bank operated by the FDIC.

The prohibition on federal assistance does not prevent insured depository institutions from establishing swaps-entity-affiliates, so long as the insured depository institution is part of a BHC or SLHC supervised by the Fed.

Insured depository institutions still may engage in "*bona fide* hedging" of their own risks and engage in less "risky" [security-based] swap contracts, including those "permissible for investment by a national bank." They may not, however, act as a swaps entity for credit default swaps ("CDS") activity, unless the CDS are cleared.

Insured depository institutions will have up to 24 months to divest themselves of their swaps entity or cease activities that require registration as a swaps entity. When determining the length of the transition period, banking regulators must make written findings regarding the effects that the divestiture or cessation of activities will have on mortgage lending, small business lending, job creation, and capital formation. In consultation with the SEC and CFTC, the banking regulators may extend the transition period up to one additional year. [Security-based] swaps entered into prior to the end of the transition period are excluded from Section 716's prohibitions. The swaps-desk spin-off must take place two years following the Act's effective date.

FDIC-insured institutions that are put into receivership or declared insolvent because of [security-based] swap activity may have that activity terminated. The provision states that no taxpayer funds may be used to prevent any swap entity's receivership. Institutions subject to heightened prudential regulation under Section 113 because they pose a systemic risk will have their [security-based] swap activities terminated if they are put into receivership or declared insolvent. Again, no taxpayer funds may be used to prevent their receivership, nor may they be used to prevent the receivership of any other institution because of [security-based] swap activities.

In prescribing rules for swaps entities, the prudential regulators must consider the expertise and managerial strength of the entity, its financial strength, its risk control systems, and its systems for monitoring and controlling its participation in existing and new markets. The

Council may determine that if other provisions are not sufficient to mitigate systemic risk, swaps entities may not access federal assistance with respect to any [security-based] swap or other activity of the swaps entity. **Sec. 716 (pp. 278-281)**.

This provision was one of the most contentious during the conference. The House bill contained no swap desk spin-off provision, while the Senate bill, at Senator Lincoln's behest, contained a stronger provision which would have required all FDIC-insured institutions to spin off all their derivatives activities. Members on both sides of the aisle had concerns about the provision.

F. New Product Approval—CFTC-SEC Process

Title VII amends the Commodity Exchange Act and the Exchange Act of 1934 to give the CFTC authority to regulate swaps and the SEC authority to regulate security-based swaps. Certification of new products is stayed pending the determination by the relevant Commission that the product is a swap or security-based swap. **Sec. 717 (pp. 281-283)**.

G. Determining the Status of Novel Derivative Products

A person filing a proposal to list or trade a novel derivative product that may have characteristics of both a security and contracts of sale of a commodity for future delivery may file concurrently with the SEC and CFTC. Even if no notice of concurrent filing is given, however, the SEC or CFTC may ask the other Commission to render judgment on the product's category. The SEC or CFTC must issue the determination within 120 days of the receipt of the request. The SEC or CFTC may petition the D.C. Court of Appeals regarding a final order of the other Commission with respect to a novel derivative product. **Sec. 718 (pp. 283-285)**.

H. Studies

Title VII requires the CFTC and SEC to conduct a number of studies. The CFTC, in consultation with entities designated as contract markets, must conduct a study on the effects of position limits imposed under the title on excessive speculation and the migration of transactions offshore. The CFTC chairman also must submit biennial reports on the growth or decline of the U.S. and foreign derivatives markets. The SEC and CFTC must conduct a joint study regarding the feasibility of requiring the derivatives industry to adopt standardized, computer-readable algorithmic descriptions for complex and standardized financial derivatives. The SEC and CFTC must conduct a joint study regarding international swap regulation. They also must study whether stable value contracts fall within the "swap" definition. **Sec. 719 (pp. 285-288).**

I. CFTC-FERC Memorandum of Understanding

Within 180 days of enactment, the CFTC and FERC must negotiate a memorandum of understanding to establish procedures for applying their respective authorities, resolving conflicts of overlapping jurisdiction, and avoiding conflicting or duplicative regulation. They also must negotiate a memorandum of understanding to share information regarding investigations into potential market manipulation, fraud, or power abuse. **Sec. 720 (p. 288)**.

J. Regulation of [Security-Based] Swap Markets

1. Definitions

The definitions sections include numerous definitions. The most important ones are:

Major [Security-Based] Swap Participant

The MSP definition includes "any person who is not a [security-based] swap dealer, and – (i) maintains a substantial position in [security-based] swaps for any of the major [security-based] swap categories as determined by the Commission, excluding – (I) positions held for hedging or mitigating commercial risk; and (II) positions maintained by any employee benefit plan . . . for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan; [or] (ii) whose outstanding [security-based] swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or (iii)(I) is a financial entity, that is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by an appropriate Federal banking agency; and (II) maintains a substantial position in outstanding [security-based] swaps in any major [security-based] swap category as determined by the Commission." The relevant Commission must define the term "substantial position." In setting capital requirements for a person that is designated as an MSP for a single type of [security-based] swap, the prudential regulator and relevant Commission must consider the other swaps and the value and quality of collateral held against counterparty exposures.

The MSP definition excludes captive finance companies, which the text defines as "an entity whose primary business if providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company." Thus, those affiliate companies wholly owned by a parent company, whose purpose is to provide financing for customers purchasing the parent company's products—will be exempt from clearing requirements for swaps entered to mitigate risk. **Sec. 721 (p. 294) and Sec. 761 (pp. 387-388)**.

The MSP definition has been a point of contention throughout the debate on derivatives regulation reform. The House definition was more narrowly tailored and less likely to capture end users using swaps to hedge their risk. The broader Senate definition was drafted several months after the House version and reflected the rising tide of populist sentiment. The final conference position incorporates more of the Senate definition, but adds the exclusion for captive finance companies.

[Security-Based] Swap

The terms "security-based swap" and "swap" include a wide variety of derivative transactions enumerated in the definitions. Significantly, the definitions explicitly include foreign exchange swaps and state that foreign exchange swaps and forwards are to be considered swaps unless the Treasury Secretary makes a written determination that they should not be regulated as swaps. Even if they are not regulated as swaps, they must be reported to a swap data repository or the CFTC. The definitions specifically exclude any contract of sale of a commodity for future delivery, leverage contract, security futures product, and any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled. **Sec. 721 (pp. 296-300) and Sec. 761 (pp. 388-389)**.

[Security-Based] Swap Dealer

"[Security-based] swap dealer" means "any person who (i) holds itself out as a dealer in [security-based] swaps; (ii) makes a market in [security-based] swaps; (iii) regularly enters into [security-based] swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in [security-based] swaps."

The definition provides that no insured depository institution may be considered a [security-based] swap dealer to the extent it offers to enter into swaps with customers in connection with issuing a loan to the customers. It excludes a person that buys or sells [security-based] swaps for the person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business. The definition also excludes entities that engage in a *de minimis* quantity of [security-based] swap dealing in connection with transactions with or on behalf of its customers. **Sec. 721 (pp. 300-301) and Sec. 761 (p. 390)**.

The final language provides a *de minimis* exception, which previous drafts did not.

2. Jurisdiction - Preemption of State Insurance Law

Title VII provides that a swap is not to be considered to be insurance and may not be regulated as an insurance contract under state law. **Sec. 722 (p. 303)**.

This preemption provision has been strongly supported by end-users and others engaged in the OTC market who fear that the cost of complying with a patchwork of state insurance regulations would far outweigh the benefits of continuing their hedging activities in the derivatives market, and thereby eliminating one of their key risk-reduction tools. The National Conference of Insurance Legislators, which consists of state legislators whose main area of public policy concern is insurance, considered model legislation last year to regulate derivatives as insurance, and legislation has been offered in the New York State Assembly.

3. Clearing, Reporting, and Trade Execution

Title VII provides that any person who is a party to a [security-based] swap must submit the swap for clearing to a derivatives clearing organization ("DCO") (for swaps) or to a clearing agency (for security-based swaps). Before clearing a new type of [security-based] swap, the DCO or clearing agency must submit the type of [security-based] swap to the relevant Commission for prior approval. The Commission must provide at least a 30-day public comment period regarding any determination about clearing requirements for a type of swap. The Commission must take action within 90 days after the submission of the request. The Commissions individually must adopt rules within one year from the date of enactment to govern the submission requirements and also to govern the clearing of the [security-based] swaps once they are accepted. A Commission may stay the clearing requirement while it reviews a submission. The Commissions also must identify [security-based] swaps required to be accepted for clearing. The Commissions individually must prescribe rules to prevent evasion of the mandatory clearing requirement.

Both counterparties to an uncleared [security-based] swap must report the [security-based] swap to a registered [security-based] swap repository, or if there is no repository that will accept the [security-based] swap, then to the relevant Commission. [Security-based] swaps entered into before the enactment date must be reported to a registered repository or the relevant Commission not later than 180 days after the effective date. [Security-based] swaps entered into on or after the enactment date but before the effective date must be reported not later than 90 days after the effective date, or such other time as prescribed by the relevant Commission.

[Security-based] swaps entered into before the enactment date are exempt from the clearing requirements if they are reported, as are [security-based] swaps entered into before application of the clearing requirement. **Sec. 723 (pp. 306-310) and Sec. 763 (pp. 394-397)**.

Counterparties to [security-based] swaps subject to the clearing requirement must execute the transactions on a board of trade designated as a contract market (for swaps) or on an exchange or swap execution facility (for security-based swaps). This requirement will not apply if no board of trade or exchange or swap execution facility makes the [security-based] swap available to trade or if a commercial end user counterparty opts to use its clearing exemption. **Sec. 723 (p. 312) and Sec. 763 (pp. 399-400)**.

4. End-User Clearing Exemption

The Act provides that the clearing requirements do not apply to a [security-based] swap if one of the counterparties "(i) is not a financial entity; (ii) is using [security-based] swaps to hedge or mitigate commercial risk; and notifies the Commission . . . how it generally meets its financial obligations associated with entering into non-cleared swaps." Financial entities include [security-based] swap dealers, MSPs, commodity pools, private funds, employee benefit plans, and persons "predominately engaged in activities that are in the business of banking, or in activities that are financial in nature." The relevant Commission must consider whether to exempt small banks, savings associations, farm credit system institutions, and credit unions. The definition of "financial entity" exempts captive finance companies, whose primary purpose is to provide financing for consumers of its parent companies' or other subsidiaries' products and who use derivatives to hedge underlying commercial risks related to interest rate and foreign currency exposures.

The Act provides that if a [security-based] swap otherwise would be subject to the mandatory clearing requirement and one of the counterparties is a commercial end user, the end user counterparty may elect not to clear the [security-based] swap, but if it does choose to clear the swap, then the end user may select the derivatives clearing organization at which the [security-based] swap will be cleared. Affiliates of end users only qualify for the exception if it is acting on behalf of the end user and using the [security-based] swap to hedge or mitigate the end user's commercial risk or another affiliate that is not a financial entity. The exception does not apply to any affiliate that is a [security-based] swap dealer, MSP, an issuer that would be an investment company, a commodity pool, or a BHC with over $50 billion in consolidated assets.

Captive finance arms of end users are exempt from the margin and clearing requirements with regard to [security-based] swaps entered into to mitigate the risk of financing activities for not less than two years beginning on the date of enactment. Counterparties that are issuers of securities must have an appropriate committee of their board approve any exemption from clearing and exchange trading of security-based swaps. **Sec. 723 (pp. 310-312) and Sec. 763 (pp. 397-399)**.

The final language removes the requirement for the SEC and CFTC to use expedited rulemaking procedures to establish the clearing and exchange trading regimes.

5. Segregation Requirements for Cleared [Security-Based] Swaps

For any person to accept remuneration from a [security-based] swaps customer to margin, guarantee, or secure a [security-based] swap cleared by a derivatives clearing organization or clearing agency, the person must register with the CFTC as a futures commission merchant or with the SEC as a broker, dealer, or security-based swap dealer. Futures commission merchants and brokers, dealers, and security-based swap dealers must treat all money, securities, and property of [security-based] swaps customers received to margin, guarantee, or secure a cleared swap as belonging to the [security-based] swaps customer. They are not to be commingled with the funds of the futures commission merchant, broker, dealer, or security-based swap dealer or used on behalf of any person other than the person for whom they are held. The funds, however, may be commingled and deposited in the same one or more bank accounts with any bank, trust company, or derivatives clearing organization. The money may be invested in obligations of the United States or any state or in obligations guaranteed by the United States. **Sec. 724 (pp. 313-315) and Sec. 763 (pp. 407-410)**.

6. Segregation Requirements for Uncleared [Security-Based] Swaps

[Security-based] swap dealers and MSPs will be required to notify their counterparties at the beginning of a transaction that the counterparties have the right to require segregation of funds or other property supplied to margin, guarantee, or secure the obligations of the counterparty. If a counterparty requests segregation of assets, the [security-based] swap dealer or MSP must segregate the funds and maintain them in a separate account. The segregation requirement does not apply to variation margin payments. If the counterparty does not choose to require segregation of the funds or property, then the [security-based] swap dealer or MSP must report to its counterparty on a quarterly basis that the it is in compliance with the back office procedures agreed upon by the parties. **Sec. 724 (pp. 315-316) and Sec. 763 (pp. 408-409)**.

7. Derivatives Clearing Organizations and Clearing Agencies

DCOs must register with the CFTC. A depository institution or clearing agency registered with the SEC that is now required to be registered as a DCO with the CFTC is deemed to be registered to the extent that, before the enactment date, the depository institution cleared swaps as a multilateral clearing organization or the clearing agency cleared swaps. The SEC must share relevant information with the CFTC.

The CFTC may exempt a DCO from registration if it determines that the DCO is subject to comparable regulation by the SEC or its home country regulators. Each DCO must designate a chief compliance officer who will report to the DCO's board or senior officer, review the DCO's compliance with enumerated core principles, resolve conflicts of interest in consultation with the board, administer policies and procedures in relation to this Act, and prepare and sign an annual report. Among other topics, the core principles address reporting, recordkeeping, maintenance of sufficient capital, systemic safeguards, public disclosures, and governance standards.

The CFTC must adopt rules mitigating conflicts of interest in connection with the conduct of business by a swap dealer or MSP with a derivatives clearing organization, board of trade, or swap execution facility that clears or trades swaps in which the swap dealer or MSP has a material interest. Reported information from the DCOs will be shared with the SEC and other regulators. **Sec. 725 (pp. 316-325)**.

To reduce systemic risk, the Act provides that under no circumstances should a DCO be compelled to accept the counterparty credit risk of another clearing organization. **Sec. 725 (p. 326)**.

Similarly, clearing agencies must register with the SEC and comply with standards set by the SEC. They must designate a chief compliance officer to report to the board, resolve conflicts of interest in consultation with the board, administer policies and procedures, ensure compliance with this title, and prepare and sign annual reports. The SEC must adopt rules governing clearing agencies for security-based swaps. The SEC may exempt clearing agencies from registration if the SEC finds that the agency is subject to comparable regulation by the CFTC or its home country authorities. **Sec. 763 (p. 401)**.

8. Conflict of Interest Rulemaking

Within 180 days of enactment, the CFTC must adopt rules which may include numerical limits on the control of any DCO that clears swaps, or any swap execution facility or board of trade that posts swaps or makes swaps available for trading, by a bank holding company with total consolidated assets of $50 billion or more, a nonbank financial company supervised by the Fed, its affiliate, a nonbank financial company, a swap dealer, MSP, or associated person of a swap dealer or MSP. **Sec. 726 (pp. 326-327)**.

Likewise, within 180 days of enactment, the SEC must adopt rules which may include numerical limits on the control of any clearing agency that clears security-based swaps, or any security-based swap execution facility or board of trade that posts security-based swaps or makes security-based swaps available for trading, by a bank holding company with total consolidated assets of $50 billion or more, a nonbank financial company supervised by the Fed, its affiliate, a nonbank financial company, a swap dealer, MSP, or associated person of a swap dealer or MSP. **Sec. 765 (pp. 429-30)**.

9. Public Reporting of [Security-Based] Swap Transaction Data

The relevant Commission is required to provide by rule for the public availability of [security-based] swap transaction and pricing data. The CFTC or SEC must require real-time public reporting for all cleared and uncleared [security-based] swaps. "Real-time public reporting" means "to report data relating to a [security-based] swap transaction, including price and volume, as soon as technologically practicable after the time at which the [security-based] swap transaction has been executed." Aggregate data on uncleared [security-based] swaps must be made available in a manner that does not identify individual transactions or positions. Parties to a [security-based] swap are responsible for reporting swap transaction information to the appropriate regulator in a timely manner, defined by the relevant Commission. **Sec. 727 (pp. 327-328) and Sec. 763 (pp. 412-413)**.

10. [Security-Based] Swap Data Repositories

[Security-based] swap data repositories must register with the relevant Commission, must comply with enumerated core principles, and must share information with the other relevant Commission upon request and with other regulators. [Security-based] swap data repositories are to accept data prescribed by the SEC or CFTC for each [security-based] swap, confirm the accuracy of the data submitted with both counterparties, and maintain the data as prescribed by the CFTC or SEC. If directed by the relevant Commission, [security-based] swap data repositories must establish automated systems for monitoring and analyzing [security-based] swap data, including compliance and frequency of end user clearing exemption claims. Each [security-based] swap data repository must designate a chief compliance officer who will report to the board or senior officer of the [security-based] swap data repository, review the repository's compliance with enumerated core principles, resolve conflicts of interest in conjunction with the board, administer policies and procedures, and prepare and sign an annual report. Among other topics, the core principles address antitrust concerns, governance, reporting, and conflict of interest concerns. **Sec. 728 (pp. 328-332) and Sec. 763 (pp. 414-417)**.

11. Reporting and Recordkeeping for Uncleared [Security-Based] Swaps

Each uncleared [security-based] swap must be reported to a [security-based] swap data repository or, if no [security-based] swap data repository will accept the swap, to the CFTC or SEC. [Security-based] swaps entered into before the date of enactment must be reported within 30 days after issuance of the interim final rule or other period of time established by the CFTC or SEC. Within 90 days of enactment, the CFTC and SEC must promulgate interim final rules providing for the reporting of each [security-based] swap entered into before the enactment date. The reporting provisions will be effective on the enactment date.

In a transaction in which only one counterparty is a [security-based] swap dealer or MSP, the [security-based] swap dealer or MSP will be responsible for reporting the transaction. If one counterparty is an MSP and the other is a [security-based] swap dealer, the [security-based] swap dealer must report the transaction. Otherwise, the counterparties to the [security-based] swap must select a counterparty to report the [security-based] swap.

Individuals who enter into uncleared [security-based] swaps whose [security-based] swaps are not accepted by a [security-based] swap data repository for reporting must provide reports regarding the [security-based] swaps to the CFTC or SEC upon written request from the relevant Commission and must maintain books and records relating to the [security-based] swaps which are open to inspection by the CFTC, SEC, and other regulators. **Sec. 729 (pp. 332-333) and Sec. 766 (pp. 430-433)**.

12. Large Trader Reporting

Title VII makes it unlawful for any person to enter into any swap that the CFTC determines performs a significant price discovery function with respect to registered entities if the person directly or indirectly exceeds the CFTC's daily position limits or other position limits. The title provides an exemption if the person files a report with the CFTC regarding the transaction and keeps books and records on the transaction which are open to the CFTC and SEC. **Sec. 730 (pp. 333-334)**.

The SEC also may require reporting of large positions in security-based swaps and securities, loans, or index of securities or loans or other instruments that relate to the security-based swaps. **Sec. 763 (p. 412)**.

K. Registration and Regulation of [Security-Based] Swap Dealers and Major [Security-Based] Swap Participants

[Security-based] swap dealers and MSPs must register with the relevant Commission. The CFTC and SEC must issue rules under these sections which will provide for the registration of [security-based] swap dealers and MSPs not later than one year after the enactment date. [Security-based] swap dealers and MSPs must register with the CFTC, even if they already are registered with the SEC, and vice versa. **Sec. 731 (pp. 335-336) and Sec. 764 (pp. 417-418)**.

1. Capital and Margin Requirements

[Security-based] swap dealers and MSPs that are banks must meet minimum capital and minimum initial and variation margin requirements for uncleared [security-based] swaps set by the appropriate federal banking agency in consultation with the SEC and CFTC. Nonbank [security-based] swap dealers and MSPs must meet minimum capital and minimum initial and variation margin requirements set by the relevant Commission.

In setting capital requirements for a person designated a [security-based] swap dealer or MSP for a single type of [security-based] swap, the prudential regulator and the relevant Commission must take into account risks associated with other types of [security-based] swaps or activities engaged in by that person.

Regulators must take into account the greater risk posed by uncleared swaps when setting capital and margin requirements. When setting the requirements, regulators must ensure that they help ensure the safety and soundness of the [security-based] swap dealer or MSP and be appropriate for the risk associated with the uncleared [security-based] swaps.

As written, the margin requirements will apply even if an end user is a counterparty to the swap. The language states that the regulators "shall adopt rules for swap dealers and major swap participants . . . imposing . . . both initial and variation margin requirements on all swaps that are not cleared by a registered derivatives clearing organization." We have been told by some that the conferees did not intend to authorize the imposition of margin on uncleared swaps to which an end user is a counterparty, but the language states otherwise and the aforementioned Dodd/Lincoln letter states only that margin cannot be imposed directly on end users.

Futures commission merchants, introducing brokers, brokers, and dealers must maintain sufficient capital to comply with the "stricter of any applicable capital requirements to which such futures commission merchant, introducing broker, broker, or dealer is subject to under this Act" or the Exchange Act.

The federal banking agencies and the SEC and CFTC must permit the use of noncash collateral for margin as the regulator or Commission determines to be consistent with preserving the financial integrity of markets trading [security-based] swaps and preserving U.S. financial stability.

The SEC, CFTC, and federal banking agencies must consult at least annually on minimum capital and margin requirements and to the maximum extent possible, maintain comparable requirements to each other. **Sec. 731 (pp. 336-338) and Sec. 764 (pp. 419-421).**

Previous versions of the legislation would have required that the capital requirements for banks must contain a capital requirement that is greater than zero for cleared [security-based] swaps and a "substantially higher" capital requirement for uncleared [security-based] swaps. Capital requirements for nonbanks would have been required to be "as strict as or stricter than" the capital requirements for the depository institutions. That language was removed from the final Act.

The final text explicitly states that existing contracts do not have to be cleared or exchange traded, though they must be reported. The Act, however, does not explicitly state that margin requirements will not apply to existing trades conducted by MSPs and swap dealers. CFTC Chairman Gensler and his staff have indicated that they are not certain that the bill provides authority to impose retroactive margin requirements but that, in any event, they do not intend to impose margin requirements retroactively even it they do have such authority, but the SEC and the prudential banking regulators also have authority to impose margin requirements.

Senator Collins made an effort to secure colloquy language making it clear that the bill is not intended to authorize the imposition of margin on existing derivatives contracts, but Senators Dodd and Lincoln refused to provide assurances to end users by entering into the colloquy.

2. Reporting and Recordkeeping By [Security-Based] Swap Dealers and Major [Security-Based] Swap Participants

Each registered [security-based] swap dealer and MSP must make reports required by the relevant Commission regarding transactions, positions, and financial condition of the entity and must maintain books and records as prescribed by the relevant Commission which they keep open for inspection. Each registered [security-based] swap dealer and MSP must maintain daily trading records and recorded communications as required by the CFTC or SEC and must maintain a complete audit trail for conducting trade reconstructions. **Sec. 731 (p. 338) and Sec. 764 (pp. 421-422)**.

3. Business Conduct Standards; Documentation and Back Office Standards

Each registered [security-based] swap dealer and MSP must conform to business conduct standards prescribed by the relevant Commission regarding fraud, manipulation, and other abusive practices, supervision of its business, and adherence to position limits. [Security-based] swap dealers that provide advice to "Special Entities," which include federal, state, and local governments and pension plans, endowments, and retirement plans, may not defraud the Special Entity. Any [security-based] swap dealer that acts as an advisor to a Special Entity "shall have a duty to act in the best interests of the Special Entity." A [security-based] swap dealer or MSP offering to act as a counterparty or acting as a counterparty to a Special Entity must comply with "any duty" established by the CFTC or SEC that requires the [security-based] swap dealer or MSP to believe that the Special Entity has an independent representative.

The relevant Commission must adopt business conduct requirements establishing the standards of care for a [security-based] swap dealer or MSP in their interactions with eligible contract participants and to require the [security-based] swap dealer or MSP to disclose information to counterparties who are not also [security-based] swap dealers or MSPs regarding, among other things, information about the material risks and characteristics of a [security-based] swap, sources of remuneration in connection with the [security-based] swap, and daily marks of the [security-based] swap.

Each registered [security-based] swap dealer and MSP must conform to the relevant Commission's standards regarding the timely and accurate confirmation, processing, netting, documentation, and valuation of all [security-based] swaps. The relevant Commission must adopt rules governing documentation and back office standards. **Sec. 731 (pp. 339-341) and Sec. 764 (pp. 422-425)**.

The final version of the text, unlike the Senate draft, does *not* impose a fiduciary duty on swap dealers and MSPs engaging in transactions with Special Entities.

4. Duties of [Security-Based] Swap Dealers and Major [Security-Based] Swap Participants

Registered [security-based] swap participants and MSPs must monitor trading in [security-based] swaps to avoid violating position limits, must establish risk management systems, disclose information to regulators about their [security-based] swap transactions, and must establish internal systems to obtain necessary information to fulfill these duties. [Security-based] swap participants and MSPs must implement conflict of interest systems and must avoid violating antitrust principles. They must designate a chief compliance officer who will report to the board or senior officer, review compliance with duties, and resolve conflicts of interest in consultation with the board. The compliance officer must administer policies and procedures, ensure compliance with this Act, establish procedures for remedying noncompliance, and prepare and sign an annual report. **Sec. 731 (pp. 341-343) and Sec. 764 (pp. 425-427)**.

5. Futures Commission Merchants and Introducing Brokers Conflicts of Interest

The CFTC must require that futures commission merchants and introducing brokers implement conflict of interest systems which will establish firewalls between researchers and analysts on the one side, and those people involved in trading and clearing on the other. Futures commission merchants also must designate a chief compliance officer to report to the board, review compliance with the Act, establish policies and procedures, and prepare and sign annual reports. **Sec. 732 (pp. 343-344)**.

6. [Security-Based] Swap Execution Facilities

To operate a facility for the trading or processing of [security-based] swaps, a person must register with the CFTC as a swap execution facility or as a designated contract market (for swaps) or a national securities exchange (for security-based swaps), even if the person is already registered with the SEC as a swap execution facility. After registration, a [security-based] swap execution facility may make available for trading any [security-based] swap and facilitate the trade processing of any [security-based] swap.

If a board of trade operates both a contract market and swap execution facility that use the same electronic trade execution system, the board of trade must identify whether the electronic trading of swaps is taking place on the contract market or the swap execution facility. The same requirement applies to national securities exchanges that also operate a security-based swap execution facility.

To be registered as a [security-based] swap execution facility, the facility must comply with enumerated core principles, including compliance with rules and enforcement of trading rules. The [security-based] swap execution facility must permit trading only in [security-based] swaps not readily susceptible to manipulation and must monitor trading and trade processing. It must have the ability to obtain internal information and must adopt position limits for speculators when necessary at a level no higher than the CFTC or SEC limitation. It must ensure the financial integrity of [security-based] swaps entered on its facility, have the ability to exercise emergency authority, and maintain books and records as required by the CFTC or SEC. The core principles also address conflicts of interest, financial resources, and system safeguards, and require the designation of a chief compliance officer. The SEC or CFTC may exempt a [security-based] swap execution facility from registration if the Commission finds that the facility is subject to comparable oversight by the other Commission. **Sec. 733 (pp. 344-349) and Sec. 763 (pp. 402-407)**.

7. Designated Contract Markets

To be designated as a contract market, a board of trade must comply with enumerated core principles and must establish, monitor and enforce the rules of the contract market including regarding access requirements, the terms and conditions of contracts to be traded on the market, and rules prohibiting abusive trading practices. The core principles include requirements that the board of trade may not list contracts readily susceptible to manipulation and the board must adopt position limits as necessary for speculators not higher than the CFTC's limit. The board must have the ability to use emergency authority. The board must make information regarding the terms and conditions of the contracts of the market, rules of the market, and information regarding the operation of the market available to regulators, market participants, and the public. It must make daily trading information public, protect the financial integrity of transactions, and protect market participants from abusive practices. It must have in place disciplinary and dispute resolution procedures and governance fitness standards and take into account antitrust considerations. **Sec. 735 (pp. 350-354)**.

8. Position Limits

The CFTC must set limits on the amount of positions, other than *bona fide* hedge positions, that may be held by any person with respect to contracts of sale for future delivery or with respect to options on the contracts or commodities traded on or subject to the rules of the designated contract market. The CFTC must establish the limits within 180 days after the enactment date for exempt commodities and 270 days for agricultural commodities.

The CFTC also must establish limits, including related hedge exemption provisions, on the aggregate number or amount of positions in contracts based on the same underlying commodity that may be held by any person for each month across contracts listed by designated contract markets, contracts traded on a foreign board of exchange, swaps traded on a swap execution facility, and swaps that perform a significant price discovery function with respect to a registered entity. The CFTC may exempt any person, class of person, swap, or class of swaps from position limits. The section is effective on the date of enactment. **Sec. 737 (pp. 354-357)**.

Similarly, the SEC must establish position limits on the size of positions in any security-based swap that may be held by any person. In establishing the limits, the SEC may require any person to aggregate positions in security-based swaps and securities or group of securities or loans related to the security-based swap or any security-based swap with any security or index of securities which use the security's price, yield, value, or volatility as a material term for the security-based swap. The SEC may exempt any person, class of persons, security-based swap, or class of security-based swaps or transactions from any position limit requirements. The SEC also may direct self-regulatory organizations to adopt position limits. The SROs may require people to aggregate their positions. **Sec. 763 (pp. 410-411)**.

9. Foreign Boards of Trade

The CFTC may adopt rules requiring foreign boards of trade ("FBOTs") that provide their members and participants located in the United States direct access to electronic trading and order matching system to register with the CFTC. The CFTC must consider whether the FBOT is subject to comparable regulation by its home country authorities. The CFTC may not permit the FBOT to provide its members or participants located in the United States direct access to its electronic trading and order-matching system with respect to a transaction that settles against any price of any contracts listed for trading on a registered entity, unless the CFTC determines that the FBOT makes public daily trading information, adopts position limits, has authority to require participants to limit or reduce their positions to prevent manipulation and excessive speculation, and agrees to share information with the CFTC. The section will not affect FBOTs to which the CFTC already has granted direct access permission until 180 days after enactment. **Sec. 738 (pp. 357-359)**.

10. Legal Certainty for Swaps

The Dodd-Frank Act provides that hybrid instruments and swaps are not void for failure to comply with the Act or CFTC regulations. Swaps entered into before the date of enactment will not be subject to the mandatory clearing requirement. Position limits will not apply to a position acquired in good faith prior to the effective date of any rule, regulation, or order establishing position limits, but those positions will be attributed to the trader if the trader's position is increased after the effective date of a position limit. **Sec. 739 (pp. 360-361)**.

11. Enforcement

The CFTC has primary authority to enforce the Subtitle A of the Title VII. The SEC has primary enforcement authority to enforce Subtitle B. The federal banking agencies have exclusive authority to enforce prudential requirements with respect to [security-based] swap dealers and MSPs that are depository institutions. The prudential regulators and relevant Commission may refer cases to each other if the relevant Commission believes that a [security-based] swap dealer or MSP has violated a prudential requirement or the prudential regulators believe a [security-based] swap dealer or MSP has violated a non-prudential requirement. If action is not taken on a referral after 90 days, the referring regulator may take action.

The SEC must censure, limit the activities of, or revoke the registration of any security-based swap dealer or MSP if the SEC finds after notice and opportunity for a hearing that the punishment is in the public interest and that the dealer or MSP has committed various violations of securities law. **Sec. 741 (pp. 361-362) and Sec. 764 (pp. 427-429)**.

12. Enhanced Compliance by Registered Entities

To be designated as and maintain the designation of a board of trade as a contract market, the board must comply with enumerated core principles. To accept a new product for trading or clearing or approve a new rule, it must certify in writing to the CFTC that the product or rule complies with the Act. Rules will become effective ten business days after the CFTC receives the certification, unless the CFTC notifies the registered entity otherwise, which will stay the certification up to 90 additional days. The rule will become effective after the 90 days unless the CFTC withdraws the stay or notifies the registered entity that it objects to the rule. The CFTC must provide at least a 30-day public comment period within the 90 days. The registered entity also can seek prior CFTC approval for contracts or rules. **Sec. 745 (pp. 367-369)**.

13. Insider Trading, Antidisruptive Practices

The title prohibits insider trading related to swaps or the sharing of nonpublic information for personal gain, as well as the knowing use of nonpublic information in swaps trading. **Sec. 746 (pp. 721-25)**. The title also prohibits engaging in disruptive practices, such as violating bids or offers or spoofing, as well as using swaps to defraud others. **Sec. 746-747 (pp. 369-371)**.

14. Whistleblowers

The title gives the CFTC authority to determine the amount of awards to give to whistleblowers and provides protections for whistleblowers, including protection from retaliation. It also establishes a fund to pay whistleblowers. **Sec. 748 (pp. 371-78)**.

15. International Harmonization

The SEC, CFTC, and prudential regulators must consult with foreign regulatory authorities to establish consistent international standards for the regulation of [security-based] swaps and enter into information-sharing arrangements. **Sec. 752 (p. 382)**.

16. Effective Date

Unless otherwise provided, the derivatives provisions will take effect 360 days after enactment. **Sec. 754 (pp. 386-387) and Sec. 774 (p. 435)**.

The House Bill provided a blanket 210 days for implementation, while the Senate Bill provided 180 days. Regulators would have been hard-pressed to issue the number of rules required by the derivatives title within either of those amounts of time.

TITLE VIII: Payment, Clearing, and Settlement Supervision

Title VIII provides a specific framework for mitigating systemic risk and promoting uniform risk-management standards for systemically important financial market utilities and systemically important payment, clearing, and settlement activities conducted by financial institutions. It may be cited as the "Payment, Clearing, and Settlement Supervision Act of 2010." **Sec. 801 (p. 436)**.

A. Purpose

The Act's findings and purpose discuss that the proper functioning of the financial markets is dependent upon "safe and efficient arrangements for the clearing and settlement of payment, securities, and other financial transactions." **Sec. 802(a)(1) (p. 436)**. Payment, clearing, or settlement activities may reduce risk, but to do so must be well-designed and operate in a sound manner. **Sec. 802(a)(2) (p. 436)**. Thus, enhancements to the regulation and supervision of "systemically important financial market utilities" ("Utilities") and "systemically important payment, clearing, and settlement activities" ("Activities") are necessary for four primary reasons:

i. To provide consistency;

ii. To promote robust risk management and safety and soundness;

iii. To reduce systemic risks; and

iv. To support the stability of the broader financial system. **Sec. 802(a)(4) (p. 436)**.

To these ends, the Act authorizes the Fed to promote uniform standards for the management of risks by systemically important financial market utilities, and for the conduct of systemically important payment, clearing, and settlement activities by financial institutions. **Sec. 802(b)(1) (p. 436)**. It provides the Fed an enhanced role in the supervision of uniform risk management standards for "systemically important financial market utilities" and "systemically important payment, clearing, and settlement activities." **Sec. 802(b)(2) and (4) (p. 436)**. Finally, it strengthens the liquidity of systemically important financial market utilities. **Sec. 802(b)(3) (p. 436)**.

B. Scope of Regulatory Authority

Broad categories of financial entities and activities are subject to enhanced Fed authority under the Act. Activities subject to regulation include "a payment, clearing, or settlement activity that the Council has designated as systemically important under § 804." **Sec. 803(2) (p. 437)**. Further, "financial institutions" include all depository institutions, branches, or agencies of foreign banks, organizations operating under Sections 25 or 25A of the FR Act, credit unions, brokers and dealers, investment companies, insurance companies, investment advisors, future commission merchants, commodity trading advisors, commodity pool operators, and any company engaged in activities that are financial in nature under Section 4 of the BHC

Act. **Sec. 803(5)(A) (p. 437)**.

Similarly, "financial market utility" refers to any person who manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions. **Sec. 803(6)(A) (p. 438)**. The Act defines "payment, clearing, or settlement activity" as an activity carried out by one or more financial institutions to facilitate the completion of financial transactions, not including the offer or sale of securities. **Sec. 803(7)(A) (pp. 438-439)**.

"Financial transactions" include fund transfers, securities contracts, contracts of sale of a commodity for future delivery, forward contracts, repurchase agreements, swaps, security-based swaps, swap agreements, security-based swap agreements, foresight language contracts, financial derivatives contracts, and "any similar transaction that the Council determines to be a financial transaction for the purposes of this title." **Sec. 803(7)(B) (p. 439)**.

The Act defines "systemic importance" to mean situations where the risk of significant liquidity or credit problems threaten the stability of the financial system of the United States. **Sec. 803(9) (p. 440)**. The Council has the authority to designate those financial market utilities or payment, clearing, or settlement activities that are or are likely to become systemically important. **Sec. 804(a)(1) (p. 440)**. The Council must do so on a nondelegable basis and by a vote of not fewer than two-thirds of members then serving. The Council must consider:

i. The aggregate value of transactions processed by the utility or activity;

ii. The exposure of the utility or a financial institution engaged in activities to its counterparties;

iii. The relationship, interdependencies, or other interactions of the utility or activity with other utilities or activities;

iv. The effect the of failure or disruption to a utility or activity on critical markets, institutions or the broader financial system; and

v. Any other factors that the Council deems appropriate. Sec. 804(a)(2) (pp. 440-441).

C. Consultation and Notice and Opportunity for Hearing

Before making any determination, the Council must consult with the relevant Supervisory Agency and the Fed before making any determination. **Sec. 804(c)(1) (p. 441)**. It must provide the financial market utility or financial institution with advance notice (including notice published in the Federal Register), and the financial market utility or institution may request, in writing, a written or oral hearing before a determination may be reached. **Sec. 804(c)(2)(A)-(B) (p. 441)**. The Act does include an emergency exception by which the Council may waive the notice requirement by a two-thirds vote and an affirmative vote by the Chairperson where the waiver is necessary to prevent an immediate threat to the financial system. **Sec. 804(c)(3)(A) (p. 441)**.

D. Standards for Systemically Important Financial Market Utilities and Payment, Clearing, or Settlement Activities

The Act mandates that the Fed prescribe risk management standards, taking into consideration relevant international standards and existing prudential requirements governing operations related to payment, clearing, and settlement activities of utilities, and the conduct of designated activities by financial institutions. **Sec. 805(a)(1)(A)-(B) (p. 442)**. The CFTC and the SEC may each prescribe regulations containing risk management standards but must do so in consultation with the Council and the Fed. **Sec. 805(a)(2) (pp. 442-443)**. The objectives and principles of the standards are to promote robust risk management; promote safety and soundness; reduce systemic risks; and support the stability of the broader financial system. **Sec. 805(b) (pp. 443-444)**. The standards proscribed would regulate such areas as:

i. Risk management policies and procedures;

ii. Margin and collateral requirements;

iii. Participant or counterparty default policies and procedures;

iv. The ability to complete timely clearing and settlement of financial transactions;

v. Capital and financial resource requirements for designated financial market utilities; and

vi. Other areas that are necessary to achieve the stated objectives. **Sec. 805(c) (p. 444)**.

E. Operations of Designated Financial Market Utilities

The Fed may authorize a Federal Reserve Bank to establish and maintain an account for a designated financial market utility and provide services to that utility authorized under the FR Act to provide to a depository institution. **Sec. 806(a) (p. 444)**. The Fed may authorize a Federal Reserve Bank to provide a utility discount and borrowing privileges only in unusual or exigent circumstances, upon an affirmative vote of a majority of the Fed then serving, and after consultation with the Secretary, and upon a showing that the utility is unable to secure adequate credit accommodations from other banking institutions. **Sec. 806(b) (p. 445)**. The Fed may pay earnings on balances maintained by or on behalf of the utility, and may exempt a utility from reserve requirements. **Sec. 806(c)-(d) (p. 445)**. A designated financial market utility must provide 60-day advance notice to its Supervisory Agency of any proposed change that could materially affect the nature or level of risks presented by the utility. **Sec. 806(e)(1)(A) (p. 445)**. The Supervisory Agency must notify the utility of any objection regarding the proposed change within 60 days of the date of notice or the date any further information is received, and the utility may not implement a change to which the Agency has an objection, but if the Agency does not object within 60 days the change is allowed. **Sec. 806(e)(1)(E)-(G) (p. 446)**. Before taking any action or completing a review of a change proposed by a utility, the Supervisory Agency must consult with the Fed. **Sec. 806(e)(4) (p. 447)**.

The notice requirement on utilities is subject to an emergency exception. A Utility may implement a change, where notice would normally be required, in an emergency where immediate implementation of the change is necessary for the utility to continue to provide its services in a safe and sound manner. **Sec. 806(e)(2)(A) (p. 446)**. However, the Utility must provide notice of such a change to the Supervisory Agency within 24 hours after implementation, explaining the nature of the emergency and the reason the change was necessary. **Sec. 806(e)(2)(B)-(C) (p. 447)**. The Supervisory Agency may require rescission or modification of the change if it is not consistent with the Act. **Sec. 806(e)(2)(D) (p. 447)**.

F. Examination Of and Enforcement Actions Against Designated Financial Market Utilities

The Supervisory Agency is required to conduct examinations of a designated Utility at least once annually in order to determine the nature of its operations and risks; the financial and operational risks posed by it to financial institutions, critical markets, or the financial system; the ability of the utility to monitor and control such risks; the safety and soundness of the utility; and the designated utility's compliance with this title and the rules and orders prescribed under this title. **Sec. 807(a) (p. 447)**. If a service integral to the operation of the Utility is performed for the Utility by another entity, the Supervisory Agency may examine to ensure the provision of that service is in compliance with applicable law to the same extent as if the utility were performing the service for its own premises. **Sec. 807(b) (p. 447)**. For purposes of enforcing this provision, the Utility is subject to, and the Supervisory Agency has authority, under the FDI Act in the same manner as if the utility was an insured depository institution. **Sec. 807(c) (p. 448)**. The Supervisory Agency is required to consult with the Fed annually regarding any examinations, and the Fed has the discretion to participate in any examination led by a Supervisory Agency. **Sec. 807(d) (p. 448)**.

After consulting the Council and Supervisory Agency, the Fed may at any time recommend that the agency take enforcement action against the utility in order to prevent or mitigate significant liquidity, credit, operational, or other risks to the financial markets or to the financial stability of the United States. **Sec. 807(e)(1) (p. 448)**. The Agency must consider the Fed's recommendation and submit a response within 60 days. **Sec. 807(e)(2) (p. 448)**. If the Agency rejects the recommendation, the Fed may refer it to the Council for a binding decision on enforcement action. **Sec. 807(e)(3) (p. 448)**.

The Fed may also take enforcement action against a Utility if the Fed has reasonable cause to believe that either an action engaged in or contemplated by the Utility, or the condition of the Utility, poses an imminent risk of substantial harm to financial institutions, markets, or the broader financial system of the United States. **Sec. 807(f)(1) (pp. 448-449)**. The imminent risk of substantial harm precludes the Fed's procedural enforcement requirements. **Sec. 807(f)(1)(B) (p. 449)**. For purposes of enforcement action, the utility is considered subject to the FDI Act as if the utility were an insured depository institution. **Sec. 807(f)(2) (p. 449)**.

G. Examination Of and Enforcement Actions Against Financial Institutions Subject to Standards for Designated Activities

The appropriate financial regulator is authorized to examine a financial institution with respect to a designated activity in order to determine: the nature and scope of the activities engaged in by the financial institution; the financial and operational risks of the institution's activities that may pose a risk to the soundness of the financial institution; the financial and operational risks engaged in by the institution that may pose a risk to other institutions, markets, or the broader financial system; the resources and capabilities of the institution to monitor and control risks; and the institution's compliance with this title and other rules and orders. **Sec. 808(a) (p. 449)**. An institution subject to these standards will be subject to the appropriate provisions of the FDI Act as if the institution was an insured depository institution. **Sec. 808(b) (p. 449-450)**.

The Fed is required to consult with and provide technical assistance to the financial regulators to ensure the Fed's orders are applied in a consistent and uniform manner. **Sec. 808(c) (p. 450)**. The regulator may also request the Fed to enforce rules or titles against a financial institution; the Fed will determine, upon request, whether an action is warranted and if so will enforce compliance. **Sec. 808(d) (p. 450)**. The Act also provides back up authority to the Fed to conduct and examination and enforce the provisions of the this title against any institution; however, the title does set limits on the Fed's authority to do so, including that the Fed must have reasonable cause to believe an institution is not in compliance, has notified the financial regulator, requested the regulator to conduct and examination, and obtained the approval of the Council upon an affirmative vote of the majority of the Council. **Sec. 808(e) (pp. 450-452)**. For purposes of enforcement, the institution is subject to relevant provisions of the FDI Act, as if it were an insured deposit institution. **Sec. 808(e)(3) (p. 452)**.

H. Requests for Information, Reports, or Records

The Council is authorized to require any Utility, or institution engaged in payment, clearing, or settlement activities, to submit information the Council may need for assessing whether the Utility or institution is systemically important, but only if the Council has reasonable cause to believe that the Utility meets the standards for systemic importance. **Sec. 809(a) (p. 452)**. The Council and the Fed may each require a Utility to submit reports or data in frequency and form deemed necessary for the Council or Fed to assess the safety and soundness of the Utility and the systemic risk posed by the Utility's operations. **Sec. 809(b)(1) (p. 452)**. The Council or Fed may also require an institution partaking in a designated activity to submit reports or data to the Fed and Council with respect to conduct of the designated activity to assess whether rules and standards under this title appropriately address risks to the financial system presented by the Activity and whether the financial institutions are in compliance with the rules and regulations prescribed under this title. **Sec. 809(b)(2) (pp. 452-453)**. The Fed may, upon a majority vote of the Council, prescribe regulations that impose a recordkeeping or reporting requirement on designated clearing entities or institutions engaged in designated activities. **Sec. 809(b)(3) (p. 453)**.

However, the Fed and Council must coordinate with other federal supervisory agencies. Before requesting any material information from, or imposing reporting or recordkeeping requirements on, any utility or institutions engaged in payment, clearing, or settlement activities, the Council and Fed must coordinate with the agency or appropriate regulator to determine if the information is available from or may be obtained by the agency; if so, the agency must provide the information within 15 days. **Sec. 809(c)(1) and (d) (p. 453)**. A Supervisory Agency, financial regulator, and the Fed may disclose to each other and the Council copies of its examination report regarding any Utility or institution engaged in designated activities. **Sec. 809(c)(2) (p. 453)**. The Act further permits Supervisory Agencies, federal regulators, and the Fed to notify each other of material concerns about a utility or financial institution, and to share appropriate reports, information, or data relating to such concerns. **Sec. 809(e) (pp. 453-454)**.

I. Rulemaking

The Act gives the Fed, Supervisory Agencies, and the Council authority to prescribe rules and issue orders necessary to administer and carry out the authority granted to them under this Act. **Sec. 810 (p. 454)**.

J. Other Authority

The Act does not divest the regulator, Supervisory Agency, or any other federal or state agency of any authority derived from any other law, except that the standards prescribed by the Fed in Section 805 will supersede any less stringent requirements. **Sec. 811 (p. 454)**.

K. Consultation

The CFTC is required to consult with the Fed prior to exercising certain authorities with respect to any rule of a derivatives clearing organization for which a state of certification has been issued and prior to exercising rulemaking authority under the Wall Street Transparency a Accountability Act of 2010. **Sec. 812(a) (p. 454)**. The SEC is required to consult with the Fed prior to exercising certain authorities with respect to any proposed rule change of a clearing agency which has already been granted an extension of time for review, and prior to exercising its rulemaking authority under certain sections of the Exchange Act. **Sec. 812(b) (p. 455)**.

L. Common Framework for Designated Clearing Entity Risk Management

The CFTC and the SEC are required to coordinate with the Fed to jointly develop risk management supervision programs for designating clearing entities. No later than one year after the enactment of this act, the CFTC, the SEC, and the Fed must submit a joint report to the Committee on Banking, Housing, and Urban Affairs, and the Committee on Agriculture, Nutrition, and Forestry of the Senate, and the Committee on Financial Services and the Committee on Agriculture of the House of Representatives. The report must include recommendations for improving consistency for designated clearing entity oversight programs, promoting robust risk management by designated clearing entities, promoting robust risk management oversight by regulators, and improving regulators' ability to monitor the potential effects of a clearing entity's risk management on the U.S. financial system. **Sec. 813 (p. 455)**.

M. Effective Date

This title is effective upon the date of enactment of this Act. **Sec. 814 (p. 455)**.

TITLE IX: Investor Protections and Improvements to the Regulation of Securities

Title IX of the Act, the "Investor Protection and Securities Reform Act of 2010" (the "IPSRA"), covers a broad array of issues affecting securities markets participants, including the standard of conduct for broker-dealers and investment advisers, whistle blower and expanded liability provisions, compliance requirements for nationally recognized statistical rating organizations ("NRSROs"), executive compensation, and corporate governance.

A. Increasing Investor Protection

1. Investor Advisory Committee

The Act establishes an Investor Advisory Committee (the "IAC") with responsibility for advising and consulting with the SEC on the agency's regulatory priorities, issues relating to the regulation of securities products, trading strategies, fee structures, and the effectiveness of disclosure, and initiatives to protect investor interests and to promote investor confidence and the integrity of the securities markets. The IAC's 10-20 members must include an Investor Advocate and representatives of each of (a) the state securities commissions, (b) senior citizens, (c) individual equity and debt investors, and (d) institutional investors. **Sec. 911 (pp. 455-456)**.

2. Office of the Investor Advocate

The Act amends Section 4 of the Exchange Act to establish the Office of the Investor Advocate, the head of which reports directly to and is appointed by the SEC's Chairman, in consultation with the SEC, but who may not have worked for the SEC during the prior two years. Among other things, the Investor Advocate, who is authorized to retain or employ independent counsel and research and service staff, is responsible for assisting retail investors in resolving significant problems that they may have with the SEC or SROs, identifying areas in which investors would benefit from changes in SEC or SRO rules, identifying problems that investors may have with financial service providers and investment products, and analyzing the potential impact on investors of SEC and SRO rulemaking. The Investor Advocate must prepare an annual report to the Congressional Banking Committees on a variety of activities related to its objectives, and propose to the SEC changes to its regulations or orders, and to Congress any legislative, administrative, or personnel changes that may be appropriate to mitigate any identified problems and to promote investors' interests. Under, new paragraph (g)(5) of Section 4 of the Exchange Act, the Investor Advocate would be given *full access* to the documents of the SEC and any SRO as necessary to carry out its functions. It is unclear how this provision would apply to documents for which protection is sought under FOIA. **Sec. 915 (pp. 464-466)**.

Within 180 days of appointment, the Investor Advocate must, pursuant to Section 4(g) of the Exchange Act, appoint an Ombudsman to act as a liaison between the SEC and retail investors and to protect the confidentiality of information provided to the Investor Advocate. **Sec. 919D (p. 474)**.

3. Investor Testing

The Act amends Section 19 of the 1933 Act to allow the SEC to gather information from and consult with members of the public, including investors, academics and consultants in connection with considering or conducting rulemaking. The Act also authorizes the SEC to engage in temporary investor testing programs. **Sec. 912 (pp. 457-458)**.

4. Study and Rulemaking Regarding Obligations of Brokers, Dealers, and Investment Advisers (The "Fiduciary Duty" Provision)

Within six months of enactment, the Act directs the SEC to conduct a study to evaluate the effectiveness of and gaps or overlaps that should be addressed by rule or statute in the existing legal and regulatory standards of care for brokers, dealers, investments advisers and their associated persons when providing personalized investment advice and recommendations about securities to their respective "retail customers." A "retail customer" is defined as a natural person, or his or her legal representative, who (i) receives personalized investment advice about securities from a broker, dealer, or investment adviser, and (ii) uses such advice primarily for personal, family, or household purposes. **Sec. 913 (pp. 458, 461)**.

5. Study Considerations

In completing its study, the Act directs the SEC to consider the following items:

i. The effectiveness of existing legal and regulatory standards of care for brokers, dealers, investments advisers, and their associated persons;

ii. Any gaps, shortcomings, or overlaps in legal or regulatory standards of care relating to such persons;

iii. Retail customer understanding of differences in standards of care applicable to such persons;

iv. Any retail customer confusion related to differing standards of care and the quality of advice that they receive;

v. The regulatory, examination, and enforcement resources devoted to, and the activities of, the SEC, the states, and a national securities association to enforce the standards of care applicable to broker-dealers, investments advisers, and their respective associated persons, including the frequency, length of time, and effectiveness of such examinations in determining compliance with regulations;

vi. The substantive differences in the regulation of brokers, dealers, and investment advisers when providing personalized investment advice and recommendations about securities to retail customers;

vii. The specific instances in which regulation and oversight of investment advisers provide greater protection to retail customers than the regulation of brokers and dealers and those instances in which regulation and oversight of brokers and dealers provide greater protection to retail customers than the regulation of investment advisers;

viii. The existing legal or regulatory standards of state securities regulators and other regulators intended to protect retail customers;

ix. The potential impact on retail customers and their access to products and services of imposing on brokers, dealers, and associated persons the standards of care and other requirements applied under the Advisers Act;

x. The potential benefits and harm to retail customers, number of and additional costs to entities and individuals that would become subject to the Advisers Act, and the potential impact onto the SEC and the states, if the broker exception is eliminated from the definition of "investment adviser" in the Advisers Act;

xi. The varying level of services provided to retail customers by and the varying scope and terms of retail customer relationships with brokers, dealers, investment advisers, and their associated persons;

xii. The potential impact upon retail customers that may result from potential changes in the regulatory requirements or standards of care affecting brokers, dealers, investments advisers and their associated persons, including any potential impact on protection from fraud, and access to and the availability of personalized investment advice and recommendations about securities;

xiii. The potential added costs and expenses, including the potential impact on the profitability of their investment decisions, to retail customers, brokers, dealers, and investment advisers resulting from changes to the duty of care; and

xiv. Any other consideration the SEC considers necessary and appropriate in determining whether to conduct a rulemaking. **Sec. 913 (pp. 458-461).**

6. Report & Rulemaking

Six months after enactment of the Act, the SEC must report to the Congressional Banking Committees on any identified legal or regulatory gaps, shortcomings or overlap in legal or regulatory standards for protecting retail customers relating to the standard of care of brokers, dealers, investment advisers and their associated persons. The SEC is required to seek public comment in order to prepare its report. In consideration of the findings, conclusions, and recommendations of its report, the Act allows the SEC to commence rulemaking to address the legal or regulatory standards of care for brokers, dealers, investment advisers, and associated persons. **Sec. 913(d)-(f) (p. 461)**.

New Exchange Act Section 15 (k) grants the SEC the explicit authority to promulgate rules applying the standard of care applicable to investment advisers under Section 211 of the Advisers Act to brokers and dealers when providing personalized investment advice about securities to retail customers or such other customers as the SEC specifies by rule. The Act specifies that the receipt of commissions or other standard compensation for the sale of securities will not in and of itself be considered a violation of the standard of care by a broker or dealer. Additionally, brokers and dealers will have no continuing duty of care or loyalty to a customer after providing personalized investment advice about securities. Although a broker or dealer's sale of only proprietary or other limited range of products will not, in and or itself, be considered a violation of any applicable standard of care, the SEC may, by rule, require that the broker or dealer provide notice to each retail customer and obtain the customer's consent or acknowledgement. **Sec. 913(g) (pp. 461-462)**.

The SEC is required to facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers and investment advisers, including any material conflicts of interest. The Act also instructs the SEC to examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes that the SEC deems contrary to public interest and protection of investors. **Sec. 913(g) (pp. 462-463)**.

New Section 211(g) of the Advisers Act authorizes the SEC to promulgate rules to provide that when a broker, dealer, or investment adviser provides personalized investment advice about securities to a retail customer or such other customers as the SEC may provide, such broker, dealer, or investment adviser must act in the best interest of the customer without regard to the financial or other interests of the broker, dealer, or investment adviser. In accordance with such rules, material conflicts of interest may be disclosed and consented to by the customer. Such standard of conduct must be no less stringent than the standard applicable to investment advisers under Sections 206(1) and (2) of the Advisers Act. The SEC may not define "customer" to include an investor in a private fund managed by an investment adviser where the private fund has entered into an advisory contract with the adviser, and the receipt of compensation based on commission or fees will not, in and of itself, be considered a violation of the standard of care by a broker, dealer, or investment adviser. **Sec. 913(g) (pp. 462-463)**.

7. Harmonization of Enforcement

The Act also instructs the SEC to harmonize enforcement with respect to violations of the Exchange Act by broker-dealers and the Advisers Act by investment advisers with respect to the standard of care applicable to such broker-dealers or advisers providing personalized investment advice to retail customers. **Sec. 913(h) (p. 463-464)**.

8. Investor Disclosure Before Purchase of Investment Products and Services

New Exchange Act Section 15(n) authorizes the SEC to issue rules designating documents or information that broker-dealers must provide to retail investors before they purchase an investment product or service. Any required disclosures will need to be in a summary format and include clear and concise information about investment objectives, strategies, costs, and risks and any compensation or other financial incentive received by a broker, dealer, or other intermediary in connection with the purchase of retail investment products. **Sec. 919 (p. 471)**.

9. Streamlining of SRO Rule Filing Process

The SRO rule filing process will be streamlined by requiring the SEC, within 45 days of a proposed rule change being published in the Federal Register, to approve or disapprove of such proposed rule change or to initiate proceedings to determine if the proposed rule change should be disapproved. This initial 45-day time frame maybe extended by the SEC if the SEC published reasons as to why such extension is appropriate or the SRO consents to the longer time frame. If proceedings are initiated, the SRO is to be given an opportunity for notice and a hearing that is to be conducted within 180 days of publication of the original proposed rule change. Generally a final determination should be made on any rule within this 180-day period. **Sec. 916 (pp. 466-470)**.

10. Additional Studies

The Act requires the SEC and the Comptroller General to conduct other studies regarding investment adviser examination, financial literacy, mutual fund advertising, conflicts of interest, investor access to information on investment advisers and broker-dealers, and financial planners and the use of financial designations. The reports on these studies would be due to the Congressional Banking Committees as described below.

11. Investment Adviser Examinations

The Act requires the SEC to review the need for enhanced examination and enforcement resources for investment advisers, including the number and frequency of examinations for investment advisers, the need for an SRO for investment advisers, and approaches for examining dually registered or affiliated broker-dealers and investment advisers. The SEC must within 180 days of enactment of the IPSRA, submit a report to the Congressional Banking Committees on its findings, and use its findings to form the basis for revising any rules and regulations, as necessary, as well as recommendations for any legislative or regulatory steps that may be necessary to address any identified concerns. **Sec. 914 (p. 464)**.

12. Financial Literacy Among Investors

The SEC is required to study, and to submit a report to the Congressional Banking Committees within two years of enactment of the Act, on: (i) the existing level of financial literacy among retail investors and subgroups thereof; (ii) methods to improve the timing, content, and format of disclosures to investors with respect to financial intermediaries, investment products, and investment services; (iii) the most useful and understandable relevant information that retail investors need to make informed financial decisions before engaging a financial intermediary or purchasing an investment product or service that is typically sold to retail investors, including shares of mutual funds; (iv) methods to increase the transparency of expenses and conflicts of interests in transactions involving investment services and products, including shares of mutual funds; (v) the most effective existing private and public efforts to educate investors; and (vi) in consultation with the Financial Literacy and Education Commission, a strategy to increase the financial literacy of investors. **Sec. 917 (p. 470)**.

13. Mutual Fund Advertising

The Comptroller is required to conduct a study, and to report to the Congressional Banking Committees within 18 months after enactment of the Act, on mutual fund advertising to identify: (i) existing and proposed regulatory requirements for open-end investment company advertisements; (ii) current marketing practices for the sale of open-end investment company shares, including the use of past performance data, funds that have merged, and incubator funds; (iii) the impact of such advertising on consumers; and (iv) recommendations to improve investor protections in mutual fund advertising and additional information necessary to ensure that investors can make informed financial decisions when purchasing shares. **Sec. 918 (pp. 470-471)**.

14. Conflicts of Interest

The Comptroller is required to conduct a study, and to report to the Congressional Banking Committees within 18 months of enactment of the Act, to identify and examine potential conflicts of interest that exist between the staffs of the investment banking and equity and fixed income securities analyst functions within the same firm, and to make recommendations to Congress designed to protect investors from such conflicts. Among other things, the Comptroller is directed to consider the nature and benefits of the undertakings entered into by investment banks subject to the global research settlement, such as firewalls between research and investment banking, disclosures, limitations on soliciting investment banking business, and to recommend whether any such undertakings should be codified. **Sec. 919A (pp. 471-472)**.

15. Improved Investor Access to Information on Investment Advisers and Broker-Dealers

Within six months of enactment of the Act, the SEC is required to complete a study, including recommendations, to improve investor access to registration information (including disciplinary actions, regulatory, judicial, and arbitration proceedings) about current and previously registered brokers, dealers, investment advisers and their associated persons on the existing Central Registration Depository and Investment Adviser Registration Depository systems. Within 18 months of the completion of the study, the SEC must implement any recommendations from the study. **Sec. 919B (p. 472)**.

16. Financial Planners and the Use of Financial Designations

Within 180 days of the enactment of the Act, the Comptroller is required to conduct a study on the effectiveness of state and federal regulations to protect investors and other consumers from individuals holding themselves out as financial planners through the use of misleading titles, designations, or market materials, the current state and federal oversight structure and regulation for financial planners, the ability of investors to understand such designations, and any legal or regulatory gaps in the regulation of financial planners and other individuals who provide or offer to provide financial planning services to consumers. The study report would need to include recommendations for the appropriate regulation of financial planners and other individuals who provide similar services with respect to the sale of insurance and securities. **Sec. 919C (pp. 472-474)**.

Until the SEC promulgates rules to address the fiduciary duty and disclosure issues, the impact for broker-dealers and investment advisers when dealing with their customers and clients cannot be determined. A detailed analysis of these provisions can be found in our alert on *The Dodd-Frank Wall Street Reform and Consumer Protection Act (H.R. 4173) from the Broker-Dealer's Perspective*, available at http://www.gibsondunn.com/Publications/Pages/Dodd-FrankHR4173FromBroker-DealerPerspective.aspx.

B. Increasing Regulatory Enforcement and Remedies

1. Mandatory Pre-Dispute Arbitration Provisions

The Act amends Section 15 of the Exchange Act to provide that the SEC, by rule, may prohibit, or impose conditions or limitations on the use of, agreements that require customers or clients of brokers, dealers or municipal securities dealers to arbitrate future disputes between them arising under the securities laws. The Act makes a parallel amendment to Section 205 of the Advisers Act that provides that the SEC, by rule, may prohibit, or impose conditions or limitations on the use of, agreements that require customers or clients of investment advisers to arbitrate future disputes between them arising under the securities laws. **Sec. 921 (pp. 474-475).**

2. Rewards to and Protections of Whistleblowers

a. Rewards to Whistleblowers

The Act amends the Exchange Act by adding new Section 21F. Section 21F provides that a whistleblower who voluntarily provides information to the SEC that leads to a successful enforcement action resulting in over $1,000,000 of monetary sanctions <u>must</u> be awarded by the SEC an amount not less than 10% and not more than 30% of the monetary sanctions collected. The Act states that determination of the amount of the award shall be in the discretion of the SEC, taking into consideration the significance of the information provided, the degree of assistance provided, the programmatic interest of the SEC in deterring violations of the securities laws by rewarding whistleblowers and other factors the SEC may establish. **Sec. 922(a) (pp. 475-477).**

Under the Act, a "whistleblower" is any individual who provides, or two or more individuals acting jointly who provide, original information relating to a violation of the securities laws to the SEC derived from the individual or individuals' own independent knowledge or analysis, not previously known to the SEC from another source, and not exclusively derived from external, publicly available information. The Act prohibits awards paid to various whistleblowers, including, but not limited to, people who work for certain regulatory or law enforcement entities, people who obtain information through performance of a financial audit required by the securities laws or people who are convicted of a crime related to the action for which the information was provided. While the Act gives the SEC discretion to determine to whom or in what amount an award should be made, it does not expressly prohibit persons who are complicit in the alleged violation from collecting an award. **Sec. 922 (p. 477).**

The Act provides that a whistleblower who makes a claim for an award is always permitted to be represented by counsel and must be represented by counsel if the claim is made anonymously and is based on information anonymously provided. The Act allows a whistleblower to appeal a determination regarding an award, unless the determination relates to the amount of an award when the award is made in accordance with provisions of the Act. **Sec. 922 (pp. 477-478).**

The Act requires that a Securities and Exchange Commission Investor Protection Fund be established by the Treasury of the United States out of which whistleblower awards will be paid. The Act contains various provisions with respect to deposits and credits and the manner in which money in the fund can be invested. Under the Act, the fund would be capped at $300,000,000. Money in the fund can also be used to fund certain activities of the Inspector General of the SEC. **Sec. 922(g) (pp. 478-479).**

b. Whistleblower Protections

The Act creates new whistleblower protections for employees who provide information to or assist the SEC, authorizing a new private right of action for reinstatement, two times back pay, and other relief. This new cause of action can be brought in a federal district court within 6 years of a violation or 3 years of discovery, but in no event later than 10 years after a violation. **Sec. 922(a) (pp. 479-480).**

The Act also expands the coverage of the existing whistleblower protections given by the Sarbanes Oxley Act of 2002 (15 U.S.C. § 7211) ("SOX") by expressly including employees of subsidiaries of publicly traded companies included in their parent corporation's consolidated financial statements, extending the statute of limitations from 90 to 180 days, prohibiting mandatory predispute arbitration agreements for SOX claims, and clarifying the right to a jury trial. **Sec. 922(c) (p. 482).**

Under the Act, all information provided to the SEC by a whistleblower is confidential and privileged, although disclosure may be made to certain government agencies if such disclosure is necessary to enable other regulatory entities to accomplish the purposes of the Exchange Act. **Sec. 922 (pp. 480-481).**

The Act requires the SEC to establish an office to administer and enforce the whistleblower incentives and protection provisions explained above. This office will report annually to the Senate Banking Committee and the House Financial Services Committee on its activities, whistleblower complaints, and the SEC's response to such complaints. Under the Act, the SEC is required to issue final regulations implementing the provisions described above within 270 days of enactment. **Sec. 924 (p. 484).**

The Act also makes various conforming amendments to the securities laws related to the funding of the Securities and Exchange Commission Investor Protection Fund. **Sec. 923 (pp. 483-484).**

As a result of the incentives of the whistleblower award program, registrants, brokerage firms, and investment advisers may see an immediate increase in the number, volume and size of whistleblower complaints made to the SEC regarding their businesses. While the legislation does not create a *qui tam* right of action analogous to that contained in the False Claims Act, it provides a powerful financial incentive for persons to make claims of wrongdoing in light of the potentially significant rewards when the SEC obtains a large dollar civil money penalty. The whistleblower protections build on the SEC's enforcement cooperation initiative, which permits the SEC and its staff to assure a cooperating individual that he or she will not be charged with a violation or will receive reduced sanctions in exchange for information leading to enforcement action against others and facilitates the process of receiving testimonial use immunity from the Department of Justice. In light of the new cause of action for retaliation against a whistleblower and the associated relief of two times the amount of back pay otherwise owed, the policies companies have in place for responding to whistleblowers assume even greater importance.

3. Collateral Bars

The Act expands the SEC's enforcement authority by giving it the authority, after notice and a hearing and upon a determination that a person violated a federal securities law, to bar that person from associating with a range of SEC-regulated entities, and not just entities regulated by the specific title that was violated. Specifically, Sections 15(b)(6)(A), 15B(c)(4), and 17A(c)(4)(C) of the Exchange Act and Section 203(f) of the Advisers Act, which permit the SEC to bar a violator from association with a "broker or dealer", "municipal securities dealer", "transfer agent" or "investment adviser", respectively, are amended to allow the SEC to bar association with a "broker, dealer, investment adviser, municipal securities dealer, transfer agent, municipal adviser, or nationally recognized statistical rating organization" in each case. **Sec. 925 (pp. 484-485).**

4. Disqualifying Felons and Other "Bad Actors" From Regulation D Offerings

The Act requires that the SEC, within one year of enactment of the Act, issue rules for the disqualification of offerings and sales of securities made under Rule 506 of Regulation D of the Securities Act that disqualify any offer or sale of securities by certain felons and other "bad actors". **Sec. 926 (p. 485).**

Specifically, the SEC's rules must include disqualification provisions substantially similar to those found in Rule 262 of Regulation A of the Securities Act. Rule 262 disqualifies offers or sales by issuers; directors, officers, general partners and ten percent owners of issuers; and underwriters who have been convicted of certain offenses, enjoined by a court of certain securities-related misconduct involving false filings or who are subject to a suspension or bar from association with a securities brokerage firm or investment adviser by the SEC or a national securities exchange or association. The rules must also disqualify any offering or sale of securities by a person that is subject to a final order of a state securities, banking, insurance or similar regulator; a Federal banking agency, or the National Credit Union Administration, that (i) bars the person from (a) association with an entity regulated by such regulator; (b) engaging in the business of securities, insurance, or banking; or (c) engaging in savings association or credit union activities; or (ii) constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within the 10-year period ending on the date of the filing of the offer or sale. The rules must disqualify any offering or sale of securities by a person convicted of a felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the SEC. **Sec. 926 (p. 485).**

5. Equal Treatment of SRO Rules

The Act amends Section 29(a) of the Exchange Act, which prohibits contract provisions "binding any person to waive compliance with any provision of the Exchange Act or of any rule or regulation thereunder, or of any rule of an exchange," by substituting "rule of a self-regulatory organization" for "rule of an exchange required thereby." **Sec. 927 (p. 485); Sec. 929T (p. 501).**

6. Clarification that Section 205 of the Advisers Act Does Not Apply to State-Registered Advisers

The Act amends Section 205(a) of the Advisers Act, which imposes restrictions on the types of contracts into which investment advisers are permitted to enter, to clarify that it only applies to investment advisers registered or required to be registered with the SEC. As a result, Section 205(a) does not apply to state-registered advisers. **Sec. 928 (p. 486).**

7. Unlawful Margin Lending

The Act amends Section 7(c)(1)(A) of the Exchange Act, which makes it unlawful for any member of a national securities exchange or any broker or dealer to extend or maintain credit to or for any customer (i) on any security in contravention of the rules or regulation provided by the Fed, and (ii) without collateral, except in accordance with rules or regulations prescribed by the Fed. The Act replaces the word "and" between the two numbered clauses above with the word "or"; a substitution which has the effect of prohibiting margin lending if either of the conditions is met. **Sec. 929 (p. 486).**

8. Fair Fund Amendments

The Act amends Section 308 SOX, which provides that civil penalties obtained from a person who violates the securities laws should be added to a disgorgement fund for the benefit of the victims only if disgorgement is also required, to say that, on motion or at the direction of the SEC, civil penalties should be added to disgorgement or other funds established for the benefit of victims, regardless of whether disgorgement is also required. **Sec. 929B (p. 486).**

9. Nationwide Service of Subpoenas

The Act inserts identical provisions into the Securities Act, the Exchange Act, the Investment Company Act of 1940 ("ICA") and the Advisers Act. These provisions provide that in any action or proceeding instituted by the SEC under the respective titles in any United States district court, a subpoena issued to compel the attendance of a witness or the production of documents or things may be served at any place within the United States. The Act also provides that Rule 45(c)(3)(A)(ii) of the Federal Rules of Civil Procedure, which requires a court to quash or modify a subpoena that requires a non-party to travel more than 100 miles from where that person resides, does not apply to such subpoenas. **Sec. 929E (p. 487).**

10. Formerly Associated Persons

The Act amends numerous provisions of the Exchange Act, SOX, and the ICA to provide that the investigative and enforcement authority of the SEC and the Public Company Accounting

Oversight Board ("PCAOB") extends not only to persons currently associated with various regulated entities, but also to persons formerly associated with such entities, if the misconduct alleged occurred while the person was so associated. **Sec. 929F (pp. 487-489).**

11. SIPC Reforms

The Act amends Section 9 of the Securities Investor Protection Act of 1970 ("SIPA") by replacing the $100,000 per customer limit on cash advances from the Securities Investor Protection Corporation ("SIPC") with a limit of $250,000 per customer, to be adjusted for inflation by the Board of Directors of the SIPC, subject to approval of the SEC, no later than January 1, 2011 and every five years thereafter. **Sec. 292H (pp. 490-491).**

The Act also amends Section 5(a)(3) of the SIPA by specifying that no member of SIPC that has a customer may enter into an insolvency, receivership, or bankruptcy proceeding, under Federal or State law, without the specific consent of SIPC, except as provided in title II of the Investor Protection and Securities Reform Act of 2010. Title II sets forth provisions related to orderly liquidation. **Sec. 292H (p. 491).**

12. Protecting Confidentiality of Materials Submitted to the SEC

The Act amends the Exchange Act, the ICA and the Advisers Act to provide that the SEC must not be compelled to disclose records and information submitted to the SEC pursuant to the examinations provisions of those acts. The Act also includes provisions that have the effect of exempting such records and information from the provisions of the Freedom of Information Act (5 U.S.C. § 552) and exempting the collection of such records and information from Subchapter I of Title 44 of the United States Code, which deals with Federal Information Policy. **Sec. 929I (pp. 491-493).** These provisions substantially increase the confidentiality of information provided by brokerage firms and investment advisers in connection with data provided in SEC examinations.

13. Sharing of Privileged Information with Other Authorities

The Act amends Section 24 of the Exchange Act to provide that the SEC does not waive any privilege applicable to information by transferring it to or permitting it to be used by any agency, the PCAOB, any self-regulatory organization, any foreign securities or law enforcement authority, or any state securities or law enforcement authority. The amendment also provides that the SEC cannot be compelled to disclose privileged information obtained from a foreign securities or law enforcement authority if the authority has in good faith determined and represented to the SEC that the information is privileged. The amendment also provides that Federal agencies, the PCAOB, self-regulatory organizations, and state securities and law enforcement authorities do not waive any privilege applicable to information by transferring it to or permitting it to be used by the SEC (unless the information was obtained from a self-regulatory organization or the PCAOB and is being used by the SEC in an action against such organization). **Sec. 929K (pp. 494-495).**

These provisions are designed to enhance the ability of the SEC and the PCAOB to obtain information from overseas regulators. Many such regulators, particularly in the European Union, have declined to provide confidential data to the SEC and the PCAOB because of their view that US law did not have adequate safeguards against the dissemination of private information.

14. Enhanced Application of Antifraud Provisions

The Act enhances the application of Section 9 of the Exchange Act, which prohibits manipulation of securities prices subject to certain conditions, (i) by removing the requirement that the security be registered on a national exchange and replacing it with a requirement that the security simply not be a government security; (ii) by removing the condition in subsection (b) that the action be done by use of a facility of a national securities exchange; and (iii) by expanding the reach of subsection (c) to include brokers and dealers in addition to members of a national securities exchange. **Sec. 929L (p. 495).**

The Act also expands the reach of Section 10(a)(1) of the Exchange Act, which makes it unlawful to effect a short sale or to use a stop-loss order in connection with the purchase or sale of any security on a national securities exchange in contravention of SEC rules, by removing the requirement that the security be registered on a national exchange and replacing it with a requirement that the security simply not be a government security. **Sec. 929L (p. 495).**

The Act also enhances the application of Section 15(c)(1)(A) of the Exchange Act, which prohibits a broker or dealer from effecting any transaction in any security otherwise than on a national securities exchange of which the broker or dealer is a member, by eliminating the requirement that the security be "otherwise than on a national securities exchange of which the broker or dealer is a member." **Sec. 929L (p. 495).**

15. Aiding and Abetting Authority Under the Securities Act and the Investment Company Act

The Act expands the SEC's enforcement authority by adding a new provision to Section 15 of the Securities Act which provides that, for purposes of any action brought by the SEC under subsections (b) or (d) of Section 20 of the Securities Act (relating to actions for injunction or criminal prosecution in district court, and money penalties in civil actions, respectively), any person that knowingly or recklessly provides substantial assistance to another person in violation of a provision of the Securities Act or the rules or regulations issued thereunder <u>must</u> be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided. **Sec. 929M (pp. 495-496).**

The Act also expands the SEC's enforcement authority by adding a new provision to Section 48 of the ICA which provides that, for purposes of any action brought by the SEC under subsections (d) or (e) of Section 42 of the ICA (relating to injunctions and money penalties in civil actions, respectively), any person that knowingly or recklessly provides substantial assistance to another person in violation of a provision of the ICA or the rules or regulations issued thereunder must be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided. **Sec. 929M (p. 496).**

16. Authority to Impose Penalties for Aiding and Abetting Violations of the Investment Advisers Act

The Act expands the SEC's enforcement authority by adding a new provision to Section 209 of the Advisers Act which provides that, for purposes of an action brought by the SEC under Section 209(e) of the Advisers Act (which relates to money penalties in civil actions), any person that knowingly or recklessly has aided, abetted, counseled, commanded, induced, or procured a violation of any provision of the Advisers Act or the rules, regulation, or orders thereunder, must be deemed to be in violation of such provision, rule, regulation, or order to the same extent as the person that committed such violation. **Sec. 929N (p. 496).**

17. Aiding and Abetting Standard of Knowledge Satisfied by Recklessness

The Act further expands the enforcement authority of the SEC by amending Section 20(e) of the Exchange Act to state that the standard of knowledge applicable to aiding and abetting violations of the Exchange Act is satisfied by recklessness. **Sec. 929O (p. 496).**

18. Strengthening Enforcement by the SEC

a. Authority to Impose Civil Penalties in Cease and Desist Proceedings

The Act makes amendments to the Securities Act, the Exchange Act, the ICA and the Advisers Act that authorize the SEC to impose civil penalties in cease-and-desist proceedings. Prior to the Act, the SEC was prohibited from seeking civil monetary penalties in such proceedings. Additionally, for cease-and-desist proceedings instituted under the Securities Act, the Act adopts a three-tiered penalty grid. **Sec. 929P (pp. 496-498).**

Specifically, the Act amends Section 8A of the Securities Act by adding a new subsection which authorizes the SEC to impose a civil penalty on a person in a cease-and-desist proceeding, if the SEC finds, on the record, after notice and a hearing, that such person is violating or has violated any provision of the Securities Act, or is or was a cause of such violation, and that such penalty is in the public interest. Previously, the SEC was not able to impose civil penalties in such proceedings. The Act establishes a three-tiered system of penalties. Absent aggravating circumstances, the maximum penalty for an act or omission is $7,500 for a natural person and $75,000 for any other person. If the act or omission involves fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, the maximum penalty is $75,000 for a natural person and $375,000 for any other person. If the act or omission involves fraud, deceit, manipulation or deliberate or reckless disregard of a regulatory requirement and results in substantial losses or a risk of substantial losses, or substantial pecuniary gain to the violator, the maximum penalty is $150,000 for a natural person and $725,000 for any other person. The SEC may consider a respondent's ability to pay in determining an appropriate penalty. **Sec. 929P(a) (pp. 496-497).**

The Act amends Section 21B(a) of the Exchange Act by adding a provision that provides that in any proceeding instituted under Section 21C of the Exchange Act (relating to cease-and-desist proceedings), the SEC may impose a civil penalty if it finds, on the record, after notice and a hearing, that such person is violating or has violated any provision of the Exchange Act, or is or was a cause of such violation. **Sec. 929P(a) (p. 497).**

The Act amends Section 9(d)(1) of the ICA by adding a provision that provides that in any proceeding instituted pursuant to Section 9(f) of the ICA (relating to cease-and-desist proceedings), the SEC may impose a civil penalty if it finds, on the record, after notice and a hearing, that such person is violating or has violated any provision of the ICA, or is or was a cause of such violation. **Sec. 929P(a) (pp. 497-498).**

The Act amends Section 203(i)(1) of the Advisers Act by adding a provision that provides that in any proceeding instituted pursuant to Section 203(k) of the Advisers Act (relating to cease-and-desist proceedings), the SEC may impose a civil penalty if it finds, on the record, after notice and a hearing, that such person is violating or has violated any provision of the Advisers Act, or is or was a cause of such violation. **Sec. 929P(a) (p. 498).**

By giving the SEC the ability to seek an order requiring payment of a civil money penalty in cease-and-desist proceedings, the Act makes available to the SEC a key enforcement remedy that was previously available only in administrative proceedings involving broker dealers, investment advisers, investment companies and their associated persons.

This new authority gives the SEC and its enforcement division a powerful incentive to bring more cases as administrative actions. Such actions can be disadvantageous to potential defendants in that (1) administrative actions go to hearing on an accelerated schedule; (2) there is no discovery in administrative proceedings; (3) there is no right of trial by jury; and (4) factual findings by the SEC in an administrative proceeding can only be reversed on appeal if the defendant shows that the findings failed to meet the "substantial evidence" test.

b. Extraterritorial Jurisdiction of the Antifraud Provisions of the Federal Securities Laws

The Act adds new, nearly identical subsections to the Securities Act, the Exchange Act, and the Advisers Act, which provide that district courts have jurisdiction of an action or proceeding brought or instituted by the SEC or the United States alleging a violation of certain provisions of the respective acts involving (i) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the transaction occurs outside the United States and involves only foreign investors, or (ii) conduct occurring outside the United States that has a foreseeable substantial effect within the United States. The provision specified for the Securities Act is Section 17(a). The provisions specified for the Exchange Act are the antifraud provisions of that title. The provision specified for the Advisers Act is Section 206. **Sec. 929P(b) (pp. 498-499).**

In addition, the Act requires the SEC to solicit public comment and then conduct a study to determine the extent to which private rights of action under the antifraud provisions of the Exchange Act should be extended to cover conduct within the United States that constitutes a significant step in furtherance of the violation, even if the transaction occurs outside the United States and involves only foreign investors, and conduct occurring outside the United States that has a foreseeable substantial effect within the United States. The study must consider and analyze (i) the scope of such a private right of action, including whether it should extend to all private actors or whether it should be more limited to extend just to institutional investors or otherwise; (ii) what implications such a private right of action would have on international comity; (iii) the economic costs and benefits of extending a private right of action for transnational securities frauds; and (iv) whether a narrower extraterritorial standard should be adopted. A report of the study must be submitted and recommendations made to the Senate Banking committee and the House Financial Services Committee within 18 months after enactment of the Act. **Sec. 929Y (p. 505).**

The Act does not overturn the Supreme Court's June 2010 decision in *Morrison v. National Australia Bank, N.A.*, ___ U.S. ___, No. 08-1191 (June 24, 2010), which rejected the notion that the Exchange Act applies to private claims by foreign investors relating to transactions on foreign exchanges. The Act does, however, provide United States courts with extraterritorial jurisdiction over certain cases brought by the SEC and the United States. Also, this provision is significant as it extends SEC and federal criminal jurisdiction to foreign private issuers whose securities trade in the United States and to persons trading in securities abroad that may have an effect on securities markets within the United States.

The Act also directs the SEC to consider whether extraterritorial jurisdiction should apply to private actions based on the antifraud provisions of the Exchange Act.

c. Control Person Liability Under the Exchange Act

The Act amends Section 20(a) of the Exchange Act, which provides for joint and several liability of control persons, to provide that such liability includes liability to the SEC in any action brought under paragraphs (1) or (3) of Section 21(d) of the Exchange Act, which relate to injunctive proceedings and money penalties in civil actions, respectively. **Sec. 929P(c) (p. 499).**

19. Fingerprinting

The Act amends Section 17(f)(2) of the Exchange Act, which requires that every member of a national securities exchange, broker, dealer, registered transfer agent, and registered clearing agency require that its partners, directors, officers, and employees be fingerprinted, to include registered securities information processors, national exchanges, and national securities associations in the list of organizations whose members must require fingerprinting of their partners, directors, officers, and employees. **Sec. 929S (p. 501).**

20. Deadline for Completing Examinations, Inspections and Enforcement Actions

The Act amends the Exchange Act by inserting new Section 4E, which requires the SEC staff to, within 180 days of providing a written Wells notification to any person, either file an action against such person or notify the Director of the Division of Enforcement of its intent not to file an action. This deadline can be extended for additional 180 day periods if the Director of the Division of Enforcement or a designee of the Director decides that it is necessary because of the complexity of the case and notifies the Chairman of the SEC. **Sec. 929U (pp. 501-502).**

New Section 4E also requires the SEC staff to, within 180 days after the later of completion of its on-site examination or receipt of all requested records, either notify the entity being examined or inspected that the examination or inspection has concluded, has concluded without findings, or that the staff requests the entity to take corrective action. This deadline can be extended for one additional 180 day period if the head of any office or division decides that it is necessary because of the complexity of the case and notifies the Chairman of the SEC. **Sec. 929U (p. 502).**

21. Securities Investor Protection Act Amendments

The Act amends Section 4(a)(1)(C) of the SIPA to change the minimum assessment paid by SIPC members from $150 per annum to 0.02 percent of the gross revenues from the securities business of such member. **Sec. 929V(a) (p. 502).**

The Act amends Section 14(c) of the SIPA by increasing the maximum fine for prohibited acts from $50,000 to $250,000. **Sec. 929V(b) (p. 502).**

The Act also amends Section 14 of the SIPA by adding new subsection (d), which prohibits a person from falsely representing, with actual knowledge of the falsity of the representation and with intent to deceive or cause injury, that such person or another person is a member of SIPC or that any person or account is protected or is eligible for protection by SIPC. The new subsection provides that violators can be fined up to $250,000 or imprisoned for up to 5 years. The new subsection also indicates that any court with jurisdiction of a civil action arising under the SIPA may grant reasonable temporary and final injunctions, which injunctions may be served anywhere in the United States and are operative throughout the United States. **Sec. 929V(c) (pp. 502-503).**

22. Short Sale Reforms

The Act amends Section 13(f) of the Exchange Act, which relates to reports by institutional investment managers, by adding a new paragraph that requires the SEC to prescribe rules providing for the public disclosure of the name of the issuer and the title, class, CUSIP number, aggregate amount of the number of short sales of each security, and any additional information it determines to be necessary and appropriate. Such disclosure is to be made following the end of the reporting period and must occur every month. **Sec. 929X(a) (p. 504).**

The Act amends Section 9 of the Exchange Act, which relates to manipulation of securities prices, by adding a new subsection that makes it unlawful for any person, directly or indirectly, by use of interstate commerce or any facility of a national securities exchange, or for any member of a national securities exchange to effect, alone or otherwise, a manipulative short sale of a security. The new subsection requires the SEC to issue rules to ensure that the appropriate enforcement options and remedies are available for violations of the subsection. **Sec. 929X(b) (p. 504).**

The Act amends Section 15 of the Exchange Act, which relates to registration and regulation of broker and dealers, by adding new subsection (e), which requires every broker or dealer to provide notice to its customers that they may elect not to allow their fully paid securities to be used in connection with short sales. The new subsection also requires that if a broker or dealer uses a customer's securities in connection with short sales, the broker or dealer must notify the customer that the broker or dealer may receive compensation in connection with lending the customer's securities. The new subsection allows the SEC to determine, by rule, the form, content, time and manner of delivery of any notice required. **Sec. 929X(c) (pp. 504-505).**

23. GAO Study on Securities Litigation

The Act requires the Comptroller General of the United States to conduct a study on the impact of authorizing a private right of action against any person who aids or abets another person in violation of the securities laws. Such study must include (i) a review of the role of secondary actors in companies' issuance of securities; (ii) the courts' interpretation of the scope of liability for secondary actors under Federal securities laws after January 14, 2008; and (iii) the types of lawsuits decided under the Private Securities Litigation Act of 1995. A report of this study must be submitted to Congress within one year of enactment of the Act. **Sec. 929Z (p. 505).**

C. Improvements to the Regulation of Credit Rating Agencies

1. Elimination of Regulation FD Exemption

Section 939B of the Act requires the SEC to amend Regulation FD to remove the express exemption for communications with rating agencies that is set forth in Section 100(b)(2)(iii) of Regulation FD. The Act requires the SEC to revise Regulation FD on or before October 19, 2010 (90 days after enactment).

If the SEC amends Regulation FD in the exact manner specified in the Act, we do not expect this provision to have significant consequences. Regulation FD was designed to prevent selective disclosure of material nonpublic information to market participants. Rule 100(b)(1) sets forth a list of persons (broker-dealers, investment advisers, institutional money managers, investment companies and shareholders if it is reasonably foreseeable that they will trade on the basis of the information) with whom communications by an issuer or issuer representative trigger a duty of public disclosure under Regulation FD. At the time that Regulation FD was adopted, most rating agencies were registered with the SEC as investment advisers. Accordingly, to permit communications with rating agencies without triggering Regulation FD, Rule 100(b)(2)(iii) contains an exemption under which communications to rating agencies generally would not trigger Regulation FD. Since Regulation FD was adopted, however, rating agencies are now regulated under Exchange Act Section 15E, and the rating agencies that have qualified as nationally recognized statistical rating organizations ("NRSROs") generally have terminated their registration as investment advisers. Accordingly, even without the exclusion set forth in Rule 100(b)(2)(iii), rating agencies are not covered persons that trigger Regulation FD. Instead, communicating with a rating agency can be viewed as equivalent to communicating with a news reporter or with a company's commercial bank. Even if the SEC were to amend Regulation FD to include rating agencies as covered persons that trigger Regulation FD, it would not be necessary to publicly disclose information provided to a rating agency if the rating agency agreed to maintain the information in confidence, consistent with Rule 100(b)(2)(ii) of Regulation FD.

2. Rescission of Securities Act Rule 436(g)

Section 939G of the Act provides that Securities Act of 1933 (the "Securities Act") Rule 436(g) "shall have no force or effect." Securities Act Rule 436(g) provided that credit ratings issued by NRSROs on debt securities, a class of convertible debt securities or a class of preferred stock were not considered part of a registration statement prepared or certified by a person within the meaning of Sections 7 and 11 of the Securities Act. This provision reflected the view of the SEC that, without Rule 436(g), a credit rating is a statement by a person whose profession gives authority to the statement made by it, and thus is "expertized" for purposes of the Securities Act. Under the Securities Act, if a statement made by an expert is included or referred to in a Securities Act registration statement, the expert is subject to potential liability under Section 11 of the Securities Act (subject to a due diligence defense) and the issuer is required to file the expert's consent to being named in the registration statement. In connection with passage of the Act, the three major rating agencies operating in the U.S. have stated that they are not in a position to consent to being named as experts in Securities Act registration statements.

The repeal of Rule 436(g) takes effect July 22, 2010 (one day after enactment).

The repeal of Rule 436(g) has a number of significant implications for public companies and the public offering process.

a. Incorporation by Reference of Exchange Act Disclosure.

Many issuers include statements in their Forms 10-K, 10-Q and 8-K regarding their credit ratings or changes to their credit ratings. These statements are automatically incorporated by reference into such issuers' registration statements on Forms S-3, S-4 or S-8. For example, a company's Form 10-K Management's Discussion and Analysis might have a discussion of the liquidity effect of a past credit ratings downgrade or discuss loan covenants that are dependent on credit ratings. We understand from discussions with the SEC Staff that, consistent with an October 2009 SEC rule proposal relating to the use of credit ratings in registered offerings, disclosure of credit ratings in this context should not be considered to be a use in connection with an offering of securities, and thus would not trigger the consent requirements of the Securities Act. Accordingly, discussion of credit ratings for the limited purpose of disclosing changes to a credit rating, the liquidity of the registrant, the cost of funds for a registrant or the terms of agreements that refer to credit ratings, may be acceptable if the credit rating is not otherwise used in connection with a registered offering. Moreover, Section 19(a) of the Securities Act provides that no liability may attach under the Securities Act for actions taken in good faith in conformity with an SEC rule notwithstanding that the rule is subsequently rescinded. Thus, with respect to credit ratings that were incorporated by reference into or that were included in a Securities Act registration statement that became effective before July 22, 2010, there would appear to be little purpose to requiring a rating agency's consent for such credit ratings disclosure since Section 19(a) would prevent expertized liability from arising with respect to credit ratings in this circumstance. However, with respect to registration statements that become effective, or are amended, on or after July 22, 2010, companies will have to take care not to include or refer to credit ratings, including through incorporation by reference, unless they have obtained the rating agency's consent. Companies also must use caution with respect to references to credit ratings in Form 10-Ks filed on or after July 22, 2010, unless such references are made in a context consistent with the interpretive position discussed above, since the filing of a Form 10-K is deemed to effect a post-effective amendment to a registration statement.

b. Prospectus Supplements, Free Writing Prospectuses and Other Offering Material.

Disclosures of credit ratings in free-writing prospectuses under Rule 433 of the Securities Act, including pricing term sheets, and in press releases that comply with Securities Act Rule 134 do not trigger the consent requirements because these communications are not subject to Section 11. Similarly, offerings that are exempt from Securities Act registration, such as Rule 144A and Regulation S offerings, should not be affected by the rescission of Rule 436(g). In contrast, offerings of asset backed securities that are registered under the Securities Act, which have traditionally been marketed conditioned upon assignment of a specified credit rating and that, as a result, are subject to a special Securities Act rule that requires inclusion of credit ratings in the registration statement, will be suspended (or conducted as Rule 144A offerings) until the markets find a means to accommodate the rescission of Rule 436(g).

D. Improvements to the Asset-Backed Securitization Process

1. Regulation of Credit Risk Retention

a. Definition of Asset-Backed Securities

ABS is defined under new Section 3(a)(77) of the Exchange Act as "a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, including a collateralized mortgage obligation, a collateralized debt obligation, a collateralized bond obligation, a collateralized debt obligation of asset-backed securities, a collateralized debt obligation of collateralized debt obligations, and any security that the [SEC], by rule, determines to be an asset-backed security." The definition excludes securities issued by a finance subsidiary that are held by a parent company or a company controlled by the parent company if none of the securities issued by the finance subsidiary are held by an entity that is not controlled by the parent company. **Sec. 941(a) (pp. 524-525)**.

b. Credit Risk Retention Requirement

New Section 15G of the Exchange Act requires the Comptroller, the Fed, and the FDIC (collectively the "Banking Agencies") and the SEC to jointly prescribe, within 270 days of enactment of the Act, regulations that require any securitizer to retain an economic interest in a portion of the credit risk for any asset that the securitizer transfers, sells, or conveys to a third party through the issuance of an ABS. A "securitizer" is defined as an issuer of an asset-backed security or a person who originates and initiates an asset-backed security transaction by selling and transferring assets, either directly or indirectly, including through an affiliate, to an issuer. **Sec. 941(b) (p. 525)**.

The Banking Agencies, the SEC, the Secretary of Housing and Urban Development, and the Federal Housing Finance Agency (jointly the "Housing Agencies") are required to jointly promulgate, within 270 days of enactment of the Act, regulations requiring securitizers to retain an economic interest in a portion of the credit risk for any residential mortgage asset that the securitizer transfers, sells, or conveys to a third party through the issuance of an asset-backed security. **Sec. 941(b) (p. 525)**.

The regulations to be promulgated under this section would become effective with respect to securitizers and originators of ABS backed by residential mortgages one year after the date that final regulations are published in the Federal Register. **Sec. 941(b) (p. 530)**.

These risk-retention requirements are similar to those already included in the SEC's proposed amendments to its rules governing the use of "shelf registration" statements for ABS and to its Regulation AB, governing the disclosure required to be included in such registration statements (the "Proposed Regulation AB Amendments"). Those proposed amendments would require a minimum 5% risk retention, but would apply only to securitizers that sought to use shelf registration for an offering of ABS. The regulations to be promulgated under new Section 15G of the Exchange Act would apply to all ABS, no matter how they are offered and sold to investors, except those eligible for one of the exemptions described below.

c. Specific Standards for Retention of Credit Risk

The regulations requiring retention of an economic interest with respect to collateralized debt obligations, securities collateralized by collateralized debt obligations, and similar instruments collateralized by other ABS must:

- Prohibit a securitizer from hedging or otherwise transferring the credit risk that the securitizer is required to retain with respect to an asset;

- Require a securitizer to retain at least 5% of the credit risk for any asset that is not a "qualified residential mortgage" that is transferred, sold or conveyed through an asset-backed security issued by the securitizer, or that is a "qualified residential mortgage" that is transferred, sold, conveyed through an asset-backed security issued by the securitizer if one or more of the assets that collateralize the asset-backed security are not "qualified residential mortgages." Less than 5% of the credit risk for any asset that is not a "qualified residential mortgage" may be retained if the securitizer meets certain underwriting standards established by the Banking Agencies. The term "qualified residential mortgage" is to be defined by the SEC and the Banking and Housing Agencies according to specified criteria, but is to be no broader than the term "qualified mortgage" as defined under Section 129C(c)(2) of the Truth in Lending Act ("TILA"), as amended by the Consumer Financial Protection Act of 2010 and regulations adopted thereunder;

- Specify the permissible forms of risk retention, the minimum duration of the required risk retention, and that a securitizer is not required to retain any part of the credit risk for an asset that is transferred, sold, or conveyed by the securitizer through the issuance of an ABS if all the assets that collateralize the asset-backed security are "qualified residential mortgages";

- Apply to all securitizers, including those that are "insured depository institutions" within the meaning of the FDI Act;

- With respect to commercial mortgages, specify the permissible types, forms and amounts of risk retention (which may include retention of a specific amount or percentage of the total credit risk of the asset, the retention of the first-loss position by a third party purchaser that meets listed requirements, a determination by the Federal banking agencies and the SEC that the underwriting standards and controls for the asset are adequate, and provision of adequate representations and warranties and related enforcement mechanisms;

- Establish appropriate standards for retention of an economic interest with respect to collateralized debt obligations, securities collateralized by collateralized debt obligations, and similar instruments collateralized by other ABS;

- Provide, as the Banking Agencies and the SEC jointly deem appropriate, for the allocation of risk retention obligations between a securitizer and an originator in the case of a securitizer that purchases assets from an originator. An "originator" is defined as a person who, through the extension of credit or otherwise, creates a financial asset that collateralizes an asset-backed security and sells an asset directly or indirectly to a securitizer;

- Establish asset classes with separate rules for securitizers of different classes of assets, including residential mortgages, commercial mortgages, commercial loans, auto loans, and any other class of assets that the Banking and Housing Agencies deem appropriate;

- Establish exemptions, exceptions, and adjustments to the rules promulgated as would help ensure high quality underwriting standards and encourage appropriate risk management practices for securitizers and originators, improve consumer and business access to credit on reasonable terms, or otherwise be in the public interest and for the protection of investors; and

- Coordinate risk retention obligations between a securitizer and an originator by reducing the percentage risk retention obligations of the securitizer by the percentage of risk retention obligations required of the originator, considering whether assets sold to the securitizer have terms, conditions and characteristics that reflect low credit risk, whether the form and volume of transactions in the securitizations markets create incentives for imprudent organization of the type of asset to be sold to the securitizer, and the potential impact of the risk retention obligations on consumer and business access to credit on reasonable terms, which may not include the transfer of credit risk to a third party **Sec. 941(c)-(d) (pp. 526-527)**.

d. Exemptions, Exceptions and Adjustments

The Banking Agencies and the SEC are to exempt the following from the credit risk retention regulations:

i. Loans or other financial assets made, guaranteed, or purchased by any institution supervised by the Farm Credit Administration, including the Federal Agricultural Mortgage Corporation;

ii. Residential, multifamily, or healthcare facility mortgage loan assets, or securitizations based directly or indirectly on such assets, which are insured or guaranteed by the U. S. government (which would presumably include the Government National Mortgage Association ("GNMA")), but not by Fannie Mae, Freddie Mac, or any Federal home loan bank; and

iii. Qualified residential mortgages, but not excluding any ABS that is collateralized by tranches of other asset-backed securities. **Sec. 941(b) (pp. 528-529)**.

In addition, the SEC must provide for a total or partial exemption of any securitization, as appropriate in the public interest and for the protection of investors, including assets issued or guaranteed by the United States, a state, a political subdivision of a state, or any agency or instrumentality thereof (specifically excluding Fannie Mae and Freddie Mac). **Sec. 941(e) (p. 527)**.

e. Study on Risk Retention

Subtitle D directs the Banking Agencies and the SEC to conduct a study of the combined impact on each individual class of asset-backed security of the new credit risk retention requirements, including the effect of the requirements on increasing the market for federally subsidized loans, and of Financial Accounting Statements 166 and 167. This report, including any statutory and regulatory recommendations, is due to Congress within 90 days of enactment of the Act. **Sec. 941(c) (p. 530)**.

2. Disclosures and Reporting for Asset-Backed Securities

The subtitle instructs the SEC to promulgate regulations requiring issuers of ABS to disclose, for each tranche or class of security, information regarding the assets backing that security, including, among other things, the nature and extent of the compensation of the broker or originator of the assets backing the security and the amount of risk retention by the originator and securitizer. **Sec. 942(b) (p. 531)**. Similar disclosure requirements are contained in the SEC's Proposed Regulation AB Amendments.

Subtitle D also requires continued supplemental and periodic reporting under the Exchange Act for issuers of ABS, even if the number of record holders of the securities is less than 300 persons. (A similar requirement is in the SEC's Proposed Regulation AB Amendments, but only with respect to securitzers that use shelf registration.) The subtitle authorizes the SEC to suspend or terminate this filing requirement for any class of ABS on such terms and for such periods as the SEC deems necessary or appropriate. **Sec. 942(a) (pp. 530-531)**.

3. Representations and Warranties in Asset-Backed Securities Offerings

Within 180 days of enactment of the Act, the SEC is required to prescribe regulations on the use of representations and warranties in the market for ABS. These regulations are to require NRSROs to include in any report accompanying a credit rating a description of the representations, warranties, and enforcement mechanisms available to investors, and how those differ from representations, warranties, and enforcement mechanisms in issuances of similar securities. In addition, securitizers must be required to disclose fulfilled and unfulfilled repurchase requests across all trusts aggregated by the securitizer so that investors can identify those originators with underwriting deficiencies. **Sec. 943 (pp. 531-532)**.

4. Exempted Transactions under the 1933 Act

Section 4(5) of the 1933 Act, which exempts certain qualifying offers and sales of mortgage notes from registration under the 1933 Act, is repealed in its entirety. **Sec. 944 (p. 532)**.

5. Due Diligence Analysis and Disclosure in Asset-Backed Securities Issues

Within six months of enactment of the Act, the SEC is to issue rules requiring the issuer of an asset-backed security to perform a review of the assets underlying the asset-backed security and to disclose the nature of the review in the issuer's registration statement required to be filed under the Exchange Act. **Sec. 945 (p. 532)**.

6. Study on the Macroeconomic Effects of Risk Retention Requirements

The Council's Chairman is instructed to perform a study on the macroeconomic effects of the risk retention requirements issued under Subtitle D, particularly the potential beneficial effects to stabilizing the real estate market. This report is to be submitted to Congress within six months of enactment of the Act. **Sec. 946 (pp. 532-533)**.

E. Accountability and Executive Compensation

Subtitle E of Title IX contains executive compensation provisions, most of which apply to all public companies. The subtitle amends certain provisions of the Exchange Act, to impose substantive requirements and enhance disclosure obligations related to compensation practices. In addition, a provision in the subtitle also requires that federally regulated financial institutions provide enhanced compensation disclosures and prohibits incentive-based compensation arrangements that encourage "inappropriate risks" at federally regulated financial institutions.

1. Non-Binding Shareholder Vote on Executive Compensation ("Say-on-Pay")

Section 951 of the Act adds a new Section 14A to the Exchange Act that requires every public company to hold an annual, biennial or triennial non-binding shareholder advisory vote ("say-on-pay") to approve the compensation of named executive officers as disclosed pursuant to the executive compensation requirements of Item 402 of Regulation S-K. The Act makes clear that the say-on-pay votes are non-binding and will not overrule any decision of the company or its board of directors or otherwise affect the board's fiduciary duties. Companies also are required to provide for a shareholder vote no less frequently than every six years on a separate resolution to determine whether the say-on-pay vote will take place every one, two or three years. The first shareholder say-on-pay vote and first shareholder vote on the frequency of say-on-pay votes must take place at the first annual or other shareholder meeting occurring on or after January 21, 2011 (six months after enactment). **Sec. 951 (pp. 533-534)**.

Unlike the EESA, which required all TARP recipients to hold say-on-pay votes, the Act does not mandate that the SEC adopt rules or regulations to implement this provision, although the SEC has general rulemaking authority under the Exchange Act. In addition, the Act grants the SEC the authority to exempt companies from the provision taking into account, among other factors, whether the requirement disproportionately burdens small issuers.

Under current SEC rules, say-on-pay votes conducted by companies other than TARP recipients require the issuer to file a preliminary proxy statement, although we expect that the SEC will amend its rules to eliminate this requirement. The SEC also might provide guidance on how the say-on-pay vote resolution and the resolution on the frequency of say-on-pay votes can be phrased. Notably, under current SEC rules, it would be unlawful for a company to offer three alternatives with respect to the shareholder vote on the frequency of say-on-pay votes (see Rule 14a-4(b) under the Exchange Act), and such a vote raises a number of significant practical issues, including what standard is necessary for a particular alternative to be approved.

2. Disclosure of and Non-Binding Shareholder Vote on Golden Parachute Compensation

New Section 14A of the Exchange Act also provides that, in connection with a shareholder vote to approve an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all the assets of a company, each person soliciting votes on the transaction must: (1) disclose any agreements or understandings with named executive officers concerning any compensation that is based on or otherwise relates to the transaction and the total of all such compensation ("golden parachute compensation"); and (2) hold a separate non-binding shareholder advisory vote on such agreements, understandings and compensation, unless such agreements or understandings already have been subject to a say-on-pay vote by shareholders. The Act requires that the disclosure be prescribed by SEC regulations and cover all types of compensation (i.e., present, deferred or contingent), the aggregate total of the compensation and any conditions to which the compensation is subject. As with say-on-pay votes, the golden parachute advisory votes will not overrule any decision of the company or its board of directors or otherwise affect the board's fiduciary duties. The provision applies to all public companies, although the SEC has the authority to exempt companies taking into account, among other factors, whether the provision disproportionately burdens small issuers. New Section 14A's golden parachute provision applies to shareholder meetings occurring on or after January 21, 2011 (six months after enactment). **Sec. 951 (pp. 533-534)**.

In light of the golden parachute compensation provision, companies and executives may be inclined to more definitively establish change-in-control compensation arrangements in advance, so that such arrangements can be subject to approval under a say-on-pay vote instead of being separately voted on in the context of a merger, although the parameters of what it means for an agreement or understanding to have been the subject of previous say-on-pay votes by shareholders are somewhat ambiguous. Note that, depending on a transaction's circumstances, two shareholder votes on golden parachute compensation may be required, one each for the acquiring company and target company.

3. Disclosure of Institutional Investment Manager Say-on-Pay and Golden Parachute Votes

New Section 14A also requires that institutional investment managers subject to Section 13(f) of the Exchange Act disclose no less than annually how they voted on any say-on-pay and golden parachute matters. Institutional investment managers who already are required by the SEC to report how they have voted are exempt from this requirement. The requirement applies to say-on-pay and golden parachute votes that take place on or after January 21, 2011 (six months after enactment). **Sec. 951 (p. 534).**

This provision will result in increased publicity surrounding, and likely activist investor pressure on, Schedule 13F institutional money managers with respect to their proxy voting. Schedule 13Fs are filed by entities or persons who manage more than $100 million in specified exchange traded securities. While the rules will apply to entities beyond those investment companies and investment managers reporting their voting results under existing SEC rules, firms that deal primarily in options and derivatives, rather than underlying securities, may escape this provision since those securities do not count toward the Schedule 13F reporting threshold.

4. Compensation Committee Independence

Section 952 of the Act mandates that stock exchanges adopt listing standards requiring listed companies to have independent compensation committee members. Section 952 also mandates that compensation committees assess the independence of compensation consultants and other advisers to the compensation committee (including legal counsel). The requirements of Section 952 are included in a new Section 10C of the Exchange Act. The provisions of Section 10C are to be implemented through exchange listing standards. Section 10C does not apply to controlled companies. The exchanges have authority to exempt companies from Section 10C's listing requirements as they determine appropriate, taking into account the potential impact on smaller companies. Section 10C requires the SEC to adopt rules no later than July 16, 2011 (360 days after enactment), directing the exchanges to prohibit the listing of any company not in compliance with the new section's requirements. **Sec. 952 (pp. 534-537)**.

Section 10C(a) requires that each member of a board's compensation committee be independent under a definition of independence to be established by the exchanges. In adopting this definition, the exchanges must consider the sources of compensation paid to any compensation committee member (including any consulting, advisory or other compensatory fees paid) and whether the member is affiliated with the issuer. Companies will be provided with a reasonable opportunity to cure any defects prior to delisting. While the other provisions of Section 10C apply to all listed companies other than controlled companies, the exclusions in Section 10C(a) are broader, as the subsection applies to all listed companies other than controlled companies, limited partnerships, companies in bankruptcy, registered open-ended investment management companies and foreign private issuers that provide annual disclosures to shareholders of the reasons why they do not have an independent compensation committee. **Sec. 952 (pp. 534-535)**.

Section 10C(b) requires that any compensation consultant and other adviser to the compensation committee may only be selected after the compensation committee has taken into account independence factors to be established by the SEC, which factors must be competitively neutral and preserve the ability of compensation committees to retain any category of adviser. These factors must include: (1) provision of other services by the employer of the compensation consultant or adviser; (2) the amount of fees received by the employer of the compensation consultant or adviser as a percentage of its total revenue; (3) policies of the employer of the compensation consultant or adviser that are designed to prevent conflicts of interest; (4) any business or personal relationship between the compensation consultant or adviser and a member of the compensation committee; and (5) any stock of the issuer owned by the compensation consultant or adviser. **Sec. 952 (pp. 535-536)**.

Section 10C(c) provides that a compensation committee in its sole discretion may retain or obtain the advice of a compensation consultant and <u>must</u> be directly responsible for the appointment, compensation and oversight of a compensation consultant. However, the committee is not required to follow the recommendations of such consultant and must continue to exercise its own judgment in fulfilling its duties. In each proxy statement filed by an issuer for an annual meeting occurring on or after July 21, 2011 (the first anniversary of the Act's enactment), the company must disclose whether the compensation committee has retained or obtained the advice of a compensation consultant, whether the consultant's work raised any conflicts of interest and how any such conflicts are being addressed. **Sec. 952 (p. 536)**.

Section 10C(d) provides that a compensation committee also in its sole discretion may retain or obtain the advice of independent legal counsel and other advisers. Again, the committee must be directly responsible for the appointment, compensation and oversight of these advisers, but is not required to follow the recommendation of such counsel or advisers to the compensation committee. **Sec. 952 (p. 536)**.

Under Section 10C(e), issuers are required to provide appropriate funding for compensation consultants, independent legal counsel and other advisers to the compensation committee. **Sec. 952 (p. 537)**.

The compensation committee member independence provision largely parallels Exchange Act Section 10A applicable to audit committee members, and thus Rule 10A-3 under the Exchange Act provides a guide to what the listing standards for compensation committee member independence might entail, although the Act's provision is not as prescriptive. In contrast to Section 10A, Section 10C does not require compensation committees to retain any consultant or adviser used by the company. Further, the compensation committee is not required to use only independent advisers (although the statute refers to "independent legal counsel," it also allows the committee to retain "other advisers"). The disclosure requirements regarding the compensation committee's use of and independence analysis regarding compensation consultants are broader than recently adopted SEC rules regarding fees paid to compensation consultants, and thus will require disclosures of other factors (including, for example, family relationships with the consultant or the consultant's reliance on an engagement for a significant portion of his or her business) that could affect compensation consultant independence.

5. Executive Compensation Disclosures

Section 953 of the Act adds a new Section 14(i) to the Exchange Act that directs the SEC to adopt rules requiring each public company to disclose in its annual meeting proxy statement the relationship between executive compensation "actually paid" and the company's financial performance. The presentation is required to "take into account" changes in the value of the shares of stock and dividends of the company and any distributions. The disclosure may, but is not required to, include a graphic representation of this required information. The Act does not prescribe a time period in which the SEC must adopt rules implementing the "pay versus performance" disclosure requirement. **Sec. 953(a) (pp. 537-538)**.

A stock price performance graph is required to be included in a company's annual report to shareholders pursuant to existing SEC rules (see Item 201(e) of Regulation S-K), but the Act's provision is more prescriptive than the current rules and requires that companies present an explicit comparison between pay and financial performance, although it is not required to be in graphic form. This provision, along with the required say-on-pay vote, may cause companies to rethink some of the disclosure in their Compensation Discussion and Analysis ("CD&A") and focus more on graphical presentations of the links between pay and performance in various elements of compensation.

Section 953 of the Act also directs the SEC to amend Item 402 of Regulation S-K (17 C.F.R. § 229.402) to require each public company to disclose in its SEC filings described in Item 10(a) of Regulation S-K (such as its annual proxy statement): (1) the median of annual total compensation of all employees, other than the CEO (or any equivalent position); (2) the annual total compensation of the CEO (or any equivalent position); and (3) the ratio of those two amounts. For the purposes of complying with this requirement, "total compensation" must be determined in accordance with Item 402(c) of Regulation S-K (17 C.F.R. § 229.402(c)), as in effect the day before the Act's enactment. The Act does not prescribe a time period in which the SEC must adopt rules implementing the internal pay ratio disclosure requirement. **Sec. 953(b) (p. 538)**.

This provision likely will be the most difficult, expensive and time-consuming of the Act's executive compensation provisions applicable to public companies and could impose an enormous burden on companies of all sizes. Given the complexity of calculating total compensation under Item 402(c) for named executive officers, the difficulty of calculating total compensation for all employees should not be underestimated. In addition to issues such as what point in time the calculation must be done and which employees must be included (full time employees only, employees on medical or military leave, etc.), the provision will raise a host of interpretive questions that do not normally arise with respect to executive officers, such as whether statutorily prescribed benefits provided to employees in some countries are treated as perquisites.

6. Recovery of Erroneously Awarded Compensation (Clawback)

Section 954 of the Act adds a new Section 10D to the Exchange Act that requires the SEC to direct the exchanges to prohibit the listing of any company that does not adopt "clawback" policies to recover compensation in certain circumstances. Specifically, each listed company must adopt and implement a policy: (1) for disclosure of the company's policy for incentive-based compensation that is based on the financial information required to be reported under the securities laws; and (2) to recoup from any current or former executive officers incentive compensation paid during a three-year look-back period based on erroneous data if the company is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws, regardless of whether the individual was involved in misconduct that led to the restatement. The amount to be recovered is the excess of what would have been paid under the restated financial statements. The Act does not specify a time period in which the SEC is required to direct the exchanges to adopt these rules relating to clawback policies. **Sec. 954 (pp. 538-539)**.

The Act's clawback provision represents a middle ground between the provision applicable to TARP recipients under EESA and the current provision applicable to all public companies under SOX, but is more stringent than the clawback provisions voluntarily adopted by many companies. Under SOX, the clawback is limited in scope (i.e., applicable only to the Chief Executive Officer and Chief Financial Officer), duration (i.e., a twelve month look-back period) and grounds (i.e., misconduct is required). The clawback provision under EESA is not triggered by an accounting restatement, but only requires a material inaccuracy in the company's financial statements and/or performance metrics and does not contain a misconduct requirement.

There also are some ambiguities in the provision that will need to be addressed by SEC rulemaking. For example, while the provision refers to equity compensation, it is not clear that clawback policies are required to apply to all forms of equity awards, or only equity awards that are granted or vest on the basis of financial performance. In particular, institutional investors typically do not view time-vested options and stock awards as "incentive compensation" and the value of such awards is not directly tied to information reported in a company's financial statements. Note also that because the clawback policies mandated by the Act will be adopted pursuant to listing standards, it does not appear that they will be enforceable in private actions.

7. Disclosures Regarding Employee and Director Hedging

Section 955 of the Act adds a new Section 14(j) to the Exchange Act that directs the SEC to adopt rules requiring each public company to disclose in its annual proxy statement whether its employees or directors (or any of their designees) may purchase financial instruments that are designed to hedge or offset decreases in the value of securities granted to employees or directors as a part of employee compensation or other securities held directly or indirectly by the employees or directors. The Act does not prescribe a time period in which the SEC must adopt rules implementing the hedging policy disclosure requirement. **Sec. 955 (p. 539)**.

While this provision requires disclosure of policies applicable to all employees, it does not prevent an issuer from having (and disclosing) one policy that is applicable to its directors and executives and another policy applicable to rank-and-file employees. In this regard, many companies already have such policies in place for their directors and executive officers and disclose them in their CD&A.

8. Enhanced Compensation Disclosures and Certain Compensation Prohibitions for Regulated Financial Institutions

Section 956 of the Act imposes new requirements on incentive compensation paid by covered financial institutions with more than $1 billion in assets. For the purposes of this provision, a "covered financial institution" means a depository institution, registered broker-dealer, credit union, investment adviser, Fannie Mae, Freddie Mac and any other financial institution that federal regulators determine should be covered. Section 956 requires covered financial institutions to disclose to their respective federal regulators the structure of all incentive-based compensation arrangements sufficient to determine whether: (1) excessive compensation, fees or benefits are provided to executive officers, other employees, directors or principal shareholders; and (2) the incentive-based compensation arrangements could lead to material financial losses to the institution. In addition, the Act requires applicable financial regulators to prohibit incentive-based payment arrangements that in their determination encourage "inappropriate risks" by covered financial institutions, either by providing excessive compensation or by creating the possibility of material financial losses to the institution.

Although the Act does not define "excessive compensation," it does direct federal regulators to consider the compensation standards included in Section 39(c) of the Federal Deposit Insurance Act, which take into account the combined value of all benefits provided to the individual, the financial condition of the institution and the levels of compensation at comparable institutions, among other factors.

The applicable federal regulators, including the Fed, OCC, FDIC, OTS, National Credit Union Administration Board, Federal Housing Finance Agency and the SEC, are required to prescribe jointly regulations or guidelines for this provision no later than April 21, 2011 (nine months after enactment). **Sec. 956 (pp. 539-540)**.

9. Voting by Brokers

Section 957 of the Act amends Section 6(b) of the Exchange Act to require exchanges to prohibit a broker that is not the beneficial owner of a company's shares (e.g., shares held in street name on behalf of retail investors) from granting a proxy to vote the shares in connection with a shareholder vote in director elections, with respect to executive compensation or on "any other significant matter" (as determined by the SEC by rule) unless the beneficial owner has provided the broker with voting instructions. The Act does not prescribe a time by which exchanges are required to implement policies relating to the broker voting prohibition, but could be read as requiring immediate action. **Sec. 957 (pp. 540-541)**.

In effect, this provision codifies and expands the effect of the SEC's July 2009 approval of amendments to NYSE Rule 452 to eliminate uninstructed broker voting in uncontested director elections so that it also applies to say-on-pay votes and other significant matters. The provision is likely to be most significant with respect to say-on-pay votes mandated by the Act.

F. Improvements to the Management of the Securities and Exchange Commission

1. Report on Oversight of National Securities Associations

The Act requires the Comptroller General to submit to the Banking Committees a report evaluating the SEC's oversight of national securities associations registered with the SEC. **Sec. 964 (p. 545)**.

The report must evaluate the SEC's oversight with respect to: (i) the governance of such national securities associations, including the identification and management of conflicts of interest by such national securities associations; (ii) the examinations carried out by the national securities associations; (iii) the executive compensation practices of such national securities associations; (iv) the arbitration services provided by the national securities associations; (v) the review performed by national securities associations of advertising by their members; (vi) the cooperation with and assistance to State securities administrators by the national securities associations to promote investor protection; (vii) how the funding of national securities associations is used to support the mission of the national securities associations; (viii) the policies regarding the employment of former employees of national securities associations by regulated entities; (ix) the ongoing effectiveness of the rules of the national securities associations in achieving the goals of the rules; (x) the transparency of governance and activities of the national securities associations; and (xi) any other issue that has an impact, as determined by the Comptroller General, on the effectiveness of such national securities associations in performing their mission and in dealing fairly with investors and members. **Sec. 964 (p. 545)**.

This report must be submitted within 2 years after enactment of the Act and every 3 years thereafter. The Act requires the SEC to reimburse the GAO for the cost of making these reports. **Sec. 964 (pp. 545-546)**.

2. Compliance Examiners

The Act requires the Division of Trading and Markets and the Division of Investment Management to each have a staff of examiners. These examiners must perform compliance inspections and examinations of entities under the jurisdiction of their respective division and must report to the director of their respective division. **Sec. 965 (p. 546)**.

The Divisions' examination staffs are expected to supplement, but not replace, the Office of Compliance Inspections and Examinations.

G. Strengthening Corporate Governance

Subtitle G of Title IX contains amendments to the Exchange Act intended to strengthen corporate governance practices.

1. Proxy Access

Section 971 of the Act amends Section 14(a) of the Exchange Act by inserting a new Subsection (2) stating that the SEC may, but is not required to, adopt rules and regulations relating to the ability of shareholders to nominate directors in an issuer's proxy statement. Section 971 grants the SEC the authority to exempt companies from any proxy access rules, taking into account, among other factors, whether the rules disproportionately burden small issuers. **Sec. 971 (p. 549)**.

In June 2009, the SEC issued proposed proxy access rules that would: (1) establish a federal proxy access right pursuant to proposed Rule 14a-11 and related amendments; and (2) permit proxy access shareholder proposals pursuant to an amendment to Rule 14a-8 (see SEC Release No. 33-9046). The proposed Rule 14a-11 would allow a shareholder or group of shareholders to nominate directors and have those nominees included in a company's proxy materials if the shareholder or group beneficially owned a certain minimum percentage (ranging from 1-5%) of the company's voting shares for at least one year prior to submitting the nomination. The proposed amendment to Rule 14a-8 would require companies to include shareholder proposals relating to proxy access in their proxy materials, except in limited circumstances. The SEC received hundreds of comments in response to the proposed proxy access rules, some of which questioned the SEC's authority to implement the rules. The SEC currently is considering final adoption of proxy access rules.

2. Separation of Chairman and CEO

Section 972 of the Act amends Section 14B of the Exchange Act by adding a new subsection that directs the SEC to adopt rules, no later than 180 days after enactment, requiring each public company to disclose in its annual proxy statement the reasons why it has chosen the same person, or different people, to serve as chairman of the board of directors and chief executive officer (or in equivalent positions of the issuer). **Sec. 972 (pp. 549-550)**.

The Act's disclosure-based approach is similar to the proxy disclosure rules adopted by the SEC in December 2009. These rules require enhanced disclosure about a company's board leadership structure, including a discussion of: (1) whether the company has combined or separated the CEO and chairman positions; (2) if combined, whether the company has a lead independent director and the specific role of such director in the company's leadership; and (3) why the company believes its structure is the most appropriate for the company. Given the similarities between what the Act requires and the rules adopted in December 2009 by the SEC, it appears that the Act does not require the SEC to significantly alter its current rules.

H. Municipal Securities

1. Regulation of Municipal Securities and Changes to the Board of the Municipal Securities Rulemaking Board

The Act generally expands the scope and powers of the Municipal Securities Rulemaking Board (the "MSRB"), expressly authorizing the MSRB to create information systems and to assess fees and charges in connection with the operation of these systems. All of these provisions are effective on October 1, 2010. **Sec. 975(i) (p. 558)**.

Specifically, Section 15B and related provisions of the Exchange Act are amended to require municipal advisors that provide advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities or municipal advisors that undertake the solicitation of a municipal entity or obligated person to register with the SEC. Currently, Section 15B only requires the registration of municipal securities brokers and dealers. **Sec. 975(a) (p. 550)**.

The composition of the MSRB was revised to require that a majority of members are independent of the municipal security industry. Accordingly, there will be eight independent public representatives, including one investor, one municipal entity, and one member of the general public. The remaining MSRB members will consist of seven individuals associated with a broker, dealer, municipal securities dealer, or municipal advisor, including one non-bank associated representative, one bank-associated representative, and one municipal advisor. While these numbers may be adjusted, the Act requires the MSRB to include more public representatives than advisor representatives and to require as even a division as possible between the two categories of representatives. **Sec. 975(b) (pp. 550-554)**.

The MSRB is required to draft rules requiring municipal advisors, in addition to municipal securities brokers and dealers, to meet certain qualification standards and other requirements found by the MSRB to be necessary for the protection of investors, municipal entities, or obligated persons. Municipal advisors will have a fiduciary duty to municipal entities. More specifically, the MSRB will be required to draft rules requiring municipal advisors to meet continuing education requirements, professional standards, and fiduciary obligations to any municipal entity that the advisor advises. The SEC will enforce these rules. The Act also generally expands the scope and powers of the MSRB, expressly authorizing the MSRB to create information systems and to assess fees and charges in connection with the operation of these systems. **Sec. 975(b)-(c) (pp. 550-555)**.

2. Study of Increased Disclosure to Investors

The Act would require the Comptroller General to conduct a study on the disclosures required to be made by issuers of municipal securities and to make recommendations relating to these disclosure requirements, including the advisability of repealing Section 15B(d) of the Exchange Act. The Comptroller's report would be due to Congress within two years of enactment of the Act. **Sec. 976 (p. 558)**.

3. Study on the Municipal Securities Markets

The Act would also require the Comptroller General to conduct a study on the municipal securities markets, among other things comparing these markets with the corporate securities markets, and to submit a report of its findings to the Senate Banking Committee and the House Financial Services Committee within 18 months of enactment of the Act. The report will contain an analysis of the needs of the markets and investors and recommendations for how to improve the transparency, efficiency, fairness, and liquidity of trading in the municipal securities markets. Within six months of submission of the report, the SEC is instructed to submit a response detailing the actions it has taken to address the Comptroller's recommendations. **Sec. 977 (p. 559)**.

4. Funding for Government Accounting Standards Board

The Act would amend Section 19 of the Exchange Act to require a national securities association registered under the Exchange Act to establish a reasonable annual accounting support fee to fund the budget of the Government Accounting Standards Board (the "GASB"). **Sec. 978(a) (pp. 559-560)**.

The Comptroller General, in consultation with state and local government officials, would be required to study the role and importance of the GASB and the manner and level at which the GASB has been funded. This report would be due to the Senate Banking Committee and House Financial Services Committee within six months of enactment of the Act. **Sec. 978(b) (p. 560)**.

5. SEC Office of Municipal Securities

The Act would create an Office of Municipal Securities in the SEC, which will be charged with administering the rules of the SEC with respect to municipal securities brokers, dealers, advisors, issuers, and investors. The Office of Municipal Securities is required to coordinate with the MSRB on rulemaking and enforcement activities. **Sec. 979 (pp. 560-561)**.

The requirement that the MSRB draft rules to require the registration of municipal securities advisors is not unexpected in light of prior MSRB proposals.

I. Public Company Accounting Oversight Board

In relation to the Public Company Accounting Oversight Board (the "PCAOB"), Subtitle I amends SOX to: (i) allow the PCAOB to share information collected during an investigation of a public accounting firm with foreign auditor oversight authorities under certain circumstances; and (ii) clarify the PCAOB's jurisdiction over brokers and dealers and the public accounting firms that prepare their audit reports.

1. Sharing Information with Foreign Authorities

The provisions of Section 981 are intended to deal with the problem of cooperation with foreign auditor oversight authorities under the original SOX. Because the PCAOB could not inspect all of the registered foreign accounting firms, it needed to rely in some measure on local regulators in countries that had robust regulatory regimes. However, a number of countries were hostile towards a U.S. regulatory body attempting to inspect their citizens. As a result, in a number of countries, arrangements were reached for joint inspections or inspections where the local regulator would inspect facilities in the home country and the PCAOB would inspect facilities in the United States. These arrangements never worked very well because the PCAOB could not share documents with foreign regulators.

Subtitle I amends Section 105(b)(5) of SOX to provide that the PCAOB may, at its discretion, share information that it collects during an investigation of a public accounting firm with a foreign auditor oversight authority under certain circumstances. The PCAOB may share such information if a foreign government has empowered a foreign auditor oversight authority to inspect or otherwise enforce laws with respect to a public accounting firm, and if: (i) the PCAOB finds that it is necessary to accomplish the purposes of SOX; (ii) the foreign auditor oversight authority provides any assurances of confidentiality that the PCAOB requests, a description of the applicable information systems and controls of the foreign auditor oversight authority; and (iii) the PCAOB determines that it is appropriate to share such information. **Sec. 981 (p. 561)**.

A foreign auditor oversight authority is defined as a governmental body or other entity empowered by a foreign government to conduct inspections of public accounting firms or otherwise to administer or enforce laws related to the regulation of public accounting firms. **Sec. 981 (p. 283-284)**.

2. Oversight of Broker-Dealers

The provisions of Section 982 clarify the PCAOB's authority over broker-dealer auditors.

Although the PCAOB could have always inspected such auditors under SOX, the SEC was given the power to exempt such firms from PCAOB registration and inspection. For the first five or six years after SOX became effective, the SEC granted broker-dealer auditors an annual exemption. Under Section 982, such firms would clearly be subject to registration, inspection and disclosure requirements of the PCAOB.

a. Expansion of the PCAOB's Authority

Subtitle I amends Section 101 of SOX to impose registration and disclosure requirements on public accounting firms that furnish audit reports with respect to brokers and dealers, as well as to issuers. **Sec. 982 (p. 563-564)**. Such accounting firms would also be subject to investigations, disciplinary proceedings, and fees. **Sec. 982 (p. 564-565)**. A broker is defined as a person engaged in the business of effecting transactions in securities for the account of others, that is required to file a balance sheet, income statement, or other financial statement under the Exchange Act, where such financial statement is required to be certified by a registered public accounting firm. **Sec. 982(a) (p. 562)**. A dealer is defined as any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise, that is required to file a balance sheet, income statement or other financial statement under the Exchange Act, where such financial statement is required to be certified by a registered public accounting firm. **Sec. 982(a) (p. 562)**.

Subtitle I also expands the PCAOB's oversight authority from public accounting firms that service public companies to those that service all companies subject to the securities laws. **Sec. 982(b) (p. 563)**.

b. Inspections of Audit Reports for Brokers and Dealers

The PCAOB may, by rule, conduct and require a program of inspection of registered public accounting firms that provide one or more audit reports for a broker or dealer. In establishing such a program, the PCAOB may allow for differentiation among classes of brokers and dealers, as appropriate. In establishing any inspection schedules, the PCAOB must consider whether differing schedules would be appropriate with respect to registered public accounting firms that issue audit reports only for one or more brokers or dealers that do not receive, handle, or hold customer securities or cash or are not a member of the SIPC. Any rules established by the PCAOB must be subject to prior approval by the SEC. If a public accounting firm is exempt from any such program, it is not required to register with the PCAOB. **Sec. 982(e) (p. 563-564)**.

c. Investigations and Disciplinary Proceedings

Subtitle I would amend Section 105(c)(7)(B) of SOX to provide that it is unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under that subsection, to become or remain associated with any issuer, broker or dealer in an accounting or a financial management capacity. It is also unlawful for any issuer, broker, or dealer that knew or should have known, through the exercise of reasonable care, of such suspension or bar, to permit such association without the consent of the PCAOB or the SEC. **Sec. 982(f) (p. 564)**.

d. Foreign Public Accounting Firms

Section 106(a) of SOX will be amended to provide that any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer, broker, or dealer must be subject to SOX and the rules of the PCAOB and the SEC issued pursuant to SOX, in the same manner and to the same extent as a U.S. public accounting firm; except that registration with the PCAOB will not subject such foreign public accounting firms to the jurisdiction of the federal or state courts, other than with respect to controversies between such firms and the PCAOB. The PCAOB may, by rule, determine that a foreign public accounting firm, or class of such firms, that does not issue audit reports nonetheless plays such a substantial role in the preparation and furnishing of such reports for particular issuers, brokers or dealers, that is necessary or appropriate and in the public interest for the protection of investors that such a firm should be treated as a public accounting firm for purposes of registration with the PCAOB. **Sec. 982(g) (p. 564)**.

e. Funding

Section 109(d) of SOX provides that the PCAOB must establish a reasonable annual accounting support fee to maintain itself. Subtitle I will amend Section 109(d)(2) to specify that the rules of the PCAOB will provide for equitable allocation, assessment, and collection of the fee among brokers and dealers, as well as issuers. The PCAOB must also allow for differentiation among classes of brokers and dealers, as well as issuers, as appropriate. **Sec. 982(h) (p. 564)**.

The PCAOB will begin the allocation, assessment, and collection of fees with respect to brokers and dealers with the payment of support fees to fund the first full fiscal year beginning after the date of enactment of the IPSRA. **Sec. 982(h) (p. 565)**.

Any amount due from a broker or dealer (or a particular class of brokers or dealers) must be allocated among the brokers and dealers and payable by the broker or dealer (or the brokers and dealers in a particular class). The amount due from a broker or dealer must be in proportion to the net capital of the broker or dealer (before or after any adjustments), compared to the total net capital of all brokers and dealers (before or after any adjustments), in accordance with rules issued by the PCAOB. **Sec. 982(h) (p. 565)**.

f. Referral of Investigations to a Self-Regulatory Organization

The PCAOB must be permitted to refer an investigation to a SRO in the case of an investigation that concerns an audit report for a broker or dealer that is under the jurisdiction of such SRO. **Sec. 982(i) (p. 565).** The PCAOB may also, in its discretion, turn over any confidential information collected in an investigation with respect to an audit report for a broker or dealer to an SRO, if the broker or dealer is under such SRO's jurisdiction and the PCAOB finds it necessary to accomplish the purposes of SOX or to protect investors. **Sec. 982(j) (p. 565)**.

J. SEC Match Funding

Subtitle J of Title IX contains provisions relating to SEC funding, including funding authorizations for fiscal year 2011 through fiscal year 2015, changes to the budget transmittal process and the establishment of an SEC reserve fund.

1. Annual Funding Authorizations for Fiscal Year 2011 to Fiscal Year 2015

The subtitle amends Section 35 of the Exchange Act to authorize the following amounts of annual funding for the SEC: \$1.3 billion for fiscal year 2011, \$1.5 billion for fiscal year 2012, \$1.75 billion for fiscal year 2013, \$2.0 billion for fiscal year 2014, and \$2.25 billion for fiscal year 2015. (For comparison purposes, note that the SEC budget for fiscal year 2010 was \$1.119 billion.) Congress still must appropriate funding for the SEC for each fiscal year, even though the preceding amounts are authorized by the Act. **Sec. 991(c) (pp. 588-589)**.

2. Transmittal of SEC Budget Requests

The subtitle includes provisions relating to the submission of the SEC's budget that will take effect beginning in fiscal year 2012. Specifically, the subtitle amends Section 31 of the Exchange Act to provide that, after the SEC submits its annual budget to the President, the President must submit the SEC's budget to Congress "in unaltered form." The subtitle requires that the SEC include in each budget (a) an itemization of the amount of funding needed to carry out the SEC's functions, (b) an amount to be designated as contingency funding to address unanticipated needs and (c) a designation of any SEC activities for which multi-year budget authority would be suitable. **Sec. 991(d) (p. 589)**.

3. Establishment of SEC Reserve Fund

Dodd-Frank also amends Section 4 of the Exchange Act to establish a separate SEC reserve fund in the U.S. Treasury. The Act provides that the SEC must fund the reserve fund from registration fees collected under Section 6(b) of the Securities Act of 1933 and Section 24(f) of the Investment Company Act of 1940. Up to the first \$50 million of such registration fees collected by the SEC annually will be deposited in the reserve fund, provided that the total balance of the reserve fund may not exceed \$100 million for any given fiscal year. The SEC may use up to the full balance of the reserve fund during any given fiscal year, as the SEC determines is necessary to carry out its functions. This provision is effective October 1, 2011. **Sec. 991(e) (pp. 589-590)**.

TITLE X: Bureau of Consumer Financial Protection

Title X creates a new independent watchdog with the authority to regulate the offering and provision of consumer financial products or services. Consumer protection responsibilities currently handled by the OCC, OTS, FDIC, the Fed, National Credit Union Administration, and Federal Trade Commission (the "FTC") will be transferred to and consolidated in the Bureau of Consumer Financial Protection (the "Bureau"). The Bureau must seek to implement and enforce federal consumer financial protection law for the purpose of ensuring that markets for consumer financial products and services are fair, transparent, and competitive. The Bureau is charged with the mission and authority to ensure that consumers are provided with timely and comprehensible information about financial transactions and protected from unfair or deceptive acts and practices. The Bureau's primary functions are conducting financial education programs; collecting, investigating, and responding to consumer complaints; collecting and publishing information about the market for consumer financial products and identifying consumer risks; supervising persons that offer consumer financial products and services; undertaking enforcement actions to address violations of federal consumer financial law; and issuing rules, orders, and guidance to implement federal consumer financial law.

Title X also expands the application of state consumer protection laws to federally chartered depository institutions and the authority of state attorneys general to enforce applicable consumer laws. Even though the *Barnett Bank* case preemption standard was generally re-affirmed, it is likely that fewer state laws will be preempted than in recent years because of additional procedural requirements and less deferential judicial review.

A. Establishment and Administration of the Bureau

Title X provides a mandate to the Bureau to enforce federal consumer financial laws. It also establishes the Bureau's functions with regard to regulation, supervision and enforcement. **Sec. 1021 (p. 615)**.

The Bureau must seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that markets for consumer financial products and services are fair, transparent, and competitive. **Sec. 1021(a) (p. 615)**.

1. Structure of the Bureau of Consumer Financial Protection

The Bureau will be housed within the Fed. **Sec. 1011 (p. 599)**. The Director of the Bureau will be appointed by the President and confirmed by the Senate for a five-year term. **Sec. 1011 (p. 599)**. Title X includes provisions to ensure the "autonomy" of the new consumer protection bureau (see below).

2. Autonomy of the Bureau

The Fed may delegate to the Bureau the authorities to examine persons subject to Fed jurisdiction for compliance with federal consumer financial laws. The Fed may not interfere or intervene in any matters or proceedings before the Bureau, such as examinations or enforcement actions, unless specifically provided by law. The Fed is also prohibited from appointing, directing, or removing any of the Bureau's officers or employees, or consolidating any of the Bureau's functions with any of the Fed's divisions or offices. Furthermore, no rule or order of the Bureau will be subject to approval or review by the Fed. **Sec. 1012(c) (pp. 600-601)**.

B. Consumer Advisory Board

The Director will be required to establish a Consumer Advisory Board. Six of the Board's members will be appointed by the Federal Reserve Bank Presidents. **Sec. 1014 (p. 609)**.

The Director is charged with establishing special functional units to research, analyze, and report on:

- Market developments for consumer financial products or services, including market areas of alternative consumer financial products or services with high growth rates and areas of risk to consumers;
- Access to fair and affordable credit for traditionally underserved communities;
- Consumer awareness, understanding, and use of disclosures and communications regarding consumer financial products or services;
- Consumer awareness and understanding of costs, risks, and benefits of consumer financial products or services;
- Consumer behavior with respect to consumer financial products or services;
- Consumer affairs unit to offer information, guidance, and technical assistance to traditionally underserved consumers and communities;
- Unit with a toll-free telephone number, website, and database to collect and track complaints;
- Office of Fair Lending and Equal Opportunity; and
- Office of Financial Literacy. **Sec. 1013(b)-(d) (pp. 603-607).**

C. Functions of the Bureau

The Bureau will be authorized to exercise its authorities under federal consumer financial law for the purposes of ensuring that, with respect to consumer financial products and services, (1) consumers are provided with timely and understandable information to make responsible decisions about financial transactions; (2) consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination; (3) outdated, unnecessary, or unduly burdensome regulations are regularly identified and addressed in order to reduce unwarranted regulatory burdens; (4) Federal consumer financial law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition; and (5) markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation. **Sec. 1021(b) (p. 615)**.

The primary functions of the Bureau are: (1) conducting financial education programs; (2) collecting, investigating, and responding to consumer complaints; (3) collecting, researching, monitoring, and publishing information relevant to the functioning of markets for consumer financial products and services to identify risks to consumers, and the proper functioning of such markets; (4) supervising covered persons for compliance with federal consumer financial law, and taking appropriate enforcement action to address violations; (5) issuing rules, orders, and guidance implementing federal consumer financial law; and (6) performing such support activities as may be necessary or useful to facilitate the other functions of the Bureau. **Sec. 1021(c) (p. 615)**.

1. Coordination

The Bureau must coordinate with the SEC and CFTC and federal agencies and State regulators to promote consistent regulatory treatment of consumer financial and investment products and services. **Sec. 1015 (p. 609)**.

2. Reports to Congress

The Director will be required to present an annual report to Congress not later than March 31 of each year on the complaints received by the Bureau in the prior year regarding consumer financial products and services. Such report must include information and analysis about complaint numbers, types, and, where applicable, information about resolution of complaints. **Sec. 1013(b)(3)(C) (p. 604)**.

The Director of the Bureau will appear before the Senate Banking Committee and the House Financial Services Committee at semi-annual hearings. **Sec. 1016(a) (pp. 609-610)**.

The Bureau will be required to prepare and submit a report to the President and to the Senate Banking Committee and the House Financial Services Committee. **Sec. 1016(b) (p. 610)**. Such report would include: (1) a discussion of the significant problems faced by consumers in shopping for or obtaining consumer financial products or services; (2) a justification of the budget request of the previous year; (3) a list of the significant rules, orders, and initiatives adopted by the Bureau; (4) an analysis of complaints about consumer financial products or services that the Bureau has received and collected in its central database; (5) a list of the public supervisory and enforcement actions to which the Bureau was a party; (6) the actions taken regarding rules, orders, and supervisory actions with respect to covered persons which are not credit unions or depository institutions; (7) an assessment of significant actions by state attorneys general or state regulators relating to federal consumer financial law; and (8) an analysis of the efforts of the Bureau to fulfill the fair lending mission of the Bureau. **Sec. 1016(c) (p. 610)**.

D. Audits of the Bureau

The Comptroller General will be required to annually audit the financial transactions of the Bureau in accordance with the United States Generally Accepted Government Auditing Standards. **Sec. 1017(a)(5)(A) (p. 612)**.

E. Funding of the Bureau

The Fed must transfer to the Bureau the funds reasonably necessary to carry out its authorities. The Fed may transfer up to 10% of its combined expenditures in 2011, 11% in 2012, and 12% in 2013 and every year thereafter. **Sec. 1017(a)(2)(A) (pp. 610-611)**. If the Director determines that the transferred funds are insufficient, the Director must submit a report to Senate and House Appropriations Committees. There are authorized to be appropriated $200 million for each of the fiscal years from 2010 to 2014. **Sec. 1017(e) (pp. 614-615)**. The Act does not provide for assessments on covered persons to fund the Bureau.

F. Scope of the Bureau's Powers and Duties

1. Covered Persons, Service Providers, Consumers, and Activities

Title X covers any person that engages in offering or providing a consumer financial product or service. **Sec. 1002(6) (p. 591)**. A consumer financial product or service is a financial product or service offered or provided for use by consumers primarily for personal, family, or household purposes, or delivered, offered or provided in connection with such a consumer financial product or service. **Sec. 1002(5) (p. 591)**.

Financial products and services include extensions of credit and service of loans; real estate settlement services and property appraisals; taking deposits, transmitting or exchanging funds, or acting as a custodian of funds or any financial instrument for use by or on behalf of a consumer; sale, provision or issuance of a payment instrument or a stored value instrument over which the seller exercises substantial control; check cashing, collection, or guaranty services; financial data processing products or services; financial advisory services; and collection and provision of consumer report and credit history information. **Sec. 1002(13) (p. 592)**.

2. Persons and Activities Not Under the Authority of the Bureau

The Bureau does not have authority with respect to credit extended directly by merchants, retailers, or sellers of nonfinancial services exclusively to enable a consumer to purchase a nonfinancial good or service. The Bureau does not have authority over real estate brokerage activities, retailers of manufactured or modular homes, accountants or tax preparers, attorneys, employee benefit and compensation plans, or persons regulated by a state securities commission. **Sec. 1027(a) (pp. 630-632)**. The Act excludes activities related to the writing of insurance or the reinsurance of risks from the purview of the Bureau. **Sec. 1002(3) (p. 590)**.

Title X is not intended to modify the authority of the SEC or CFTC to adopt rules, initiate enforcement proceedings, or take other action with respect to persons or institutions regulated by those agencies. However, the SEC and CFTC would be required to consult and coordinate with the Bureau regarding rulemaking over any product or service subject to the Bureau's jurisdiction. **Sec. 1015 (p. 609)**.

G. Information Collection and Monitoring

The Bureau will monitor for risks to consumers in the offering or provision of consumer financial products or services, including developments in markets for such products or services. **Sec. 1022(c)(1) (p. 617)**. In allocating its resources to perform the monitoring the Bureau may consider: (1) likely risks and costs to consumers associated with buying or using a type of consumer financial product or service; (2) understanding by consumers of the risks of a type of consumer financial product or service; (3) the legal protections applicable to the offering or provision of a consumer financial product or service, including the extent to which the law is likely to adequately protect consumers; (4) rates of growth in the offering or provision of a consumer financial product or service; (5) the extent, if any, to which the risks of a consumer financial product or service may disproportionately affect traditionally underserved consumers; or (6) other pertinent characteristics of covered persons that offer or provide the consumer financial product or service. **Sec. 1022(c)(1) (p. 617)**.

The Bureau will be required to publish at least one report annually of significant findings of its monitoring. **Sec. 1022(d) (p. 620)**. In conducting research on the offering and provision of consumer financial products or services, the Bureau will have the authority to gather information from time to time regarding the organization, business conduct, markets, and activities of persons operating in consumer financial services markets. In order to gather such information, the Bureau may gather and compile information from examination reports concerning covered persons or service providers, assessment of consumer complaints, surveys and interviews of covered persons and consumers, and review of available databases. The Bureau may also require persons to file with the Bureau, under oath or otherwise, in such form and within such reasonable period of time as the Bureau may prescribe, by rule or order reports, or answers in writing to specific questions. The Bureau may make public such information but <u>must</u> prescribe rules regarding confidentiality. **Sec. 1022(c)(4) (pp. 617-618)**.

H. Rulemaking Authority

The Director will have authority to prescribe rules and issue orders and guidance to enable the Bureau to administer federal consumer financial laws. **Sec. 1022(b) (pp. 616-617)**. To the extent that a provision of federal consumer financial law authorizes the Bureau and another federal agency to issue regulations under that provision of law for purposes of assuring compliance with federal consumer financial law and any regulations thereunder, the Bureau <u>must</u> have the exclusive authority to prescribe rules subject to those provisions of law. **Sec. 1022(b)(4) (pp. 616-617)**.

1. Standards for Rulemaking

In prescribing rules, the Bureau will be required to consider the potential costs and benefits to consumers and covered persons, including any potential reduction of consumer access to financial products or services. The Bureau will need to consult with the prudential regulators and other appropriate federal agencies before proposing a rule and during the comment process. If a prudential regulator provides a written exception to the proposed rule, the Bureau must include the objection in its adopting release. **Sec. 1021(b)(2) (p. 615)**.

2. Prohibiting Unfair, Deceptive, or Abusive Acts or Practices

The Bureau is authorized to take action to prevent a person from committing an unfair, deceptive, or abusive act under federal law in connection with any consumer financial product or service transaction or offering. **Sec. 1021 (p. 615)**.

3. Regulations Regarding Arbitration Agreements

By regulation, the Director may prohibit or impose conditions or limitations on the use of mandatory pre-dispute arbitration agreements between a covered person and a consumer for a consumer financial product if such action is in the public interest and for the protection of consumers. However, the Bureau must first conduct a study of mandatory pre-dispute arbitration provisions, and any limits imposed on arbitration agreements must be consistent with the findings of the study. **Sec. 1028 (p. 639)**.

4. Regulations Governing Disclosures

The Bureau may prescribe regulations to ensure timely, appropriate and effective disclosures of costs, benefits, and risks associated with any consumer financial product or service. The Bureau may also issue model disclosures, which are per se compliant. The Bureau may permit a covered person to conduct a trial program to provide trail disclosures to consumers. **Sec. 1032 (pp. 642-643)**.

5. Review of Bureau Rules and Regulations

The Bureau will be required to conduct an assessment of each significant rule or order it adopts and publish a report within five years. In addition, on the petition of any of its member agencies, the Council may set aside any of the Bureau's regulations if it decides by two-thirds vote that regulation would put the safety and soundness of the banking system or the stability of the financial sector at risk. The agency would be required to first attempt to work with the Bureau in good faith to resolve any concerns. If this is unsuccessful, the agency would file its petition within 10 days after the publication of the regulation. **Sec. 1023 (pp. 620-622)**.

6. Exceptions

The Bureau is permitted to issue rules to exempt any covered person from any provision of Title X or regulations under Title X as the Director deems necessary or appropriate. In issuing such exemption, the Director must take into account the total assets of the covered person, its volume of transactions involving consumer financial products or services, and the extent to which existing laws or regulations adequately protect consumers. **Sec. 1022(b)(3)(A) (p. 616)**.

7. Regulations Governing Interchange Fees

Section 1075 of Dodd-Frank amends the Electronic Fund Transfer Act to create a new Section 920 regarding interchanged fees. The new provision gives the Fed authority to establish rules regarding interchange transaction fees that an issuer or payment card network may charge with respect to electronic debit transactions. The rules will require that fees be reasonable and proportional to the actual cost incurred by the issuer or payment card network with respect to the transaction. However, such rules will not apply to issuers with assets of less than $10 billion. **Sec. 1075 (pp. 704-711)**.

Rulemaking and Information Collection. The Fed is required to prescribe regulations in final form establishing standards for assessing whether an interchange fee is "reasonable and proportional to the cost incurred by the issuer with respect to the transaction" within nine months after the enactment date of the Consumer Financial Protection Act of 2010. The Board may require any issuer or payment card network to provide it the information it needs to carry out the new law and as needed to issue rules under the new law. **Sec. 1075 (p. 705)**.

Fraud Prevention Costs. The Fed can adjust the interchange fee charged by an issuer if the adjustment is "reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to electronic debt transactions involving that issuer" and the issuer complies with fraud-related standards set by the Board. The Board must issue regulations within 9 months of enactment establishing standards for making these adjustments. **Sec. 1075 (pp. 705-706**).

Small Issuers. The new requirements for interchange fees do not apply to issuers with consolidated assets of less than $10 billion. The Board must exempt such issuers from the new regulations. **Sec. 1075 (p. 707)**.

Government-Administered Payment Programs and Reloadable Prepaid Cards Exempted. The new requirements for interchange fees do not apply to fees charged or received with respect to electronic debt transactions in which a person issues a debit card provided pursuant to a Federal or State government-administered payment program or a plastic card or device link to funds which are purchased on a prepaid basis and not used to access an account held by the card holder that is redeemable at multiple merchants or teller machines and is reloadable and not marketed as a gift card. **Sec. 1075 (p. 707)**.

Dodd on Health Care Prepaid Cards. Senator Dodd in a colloquy (attached at Appendix B) clarified his understanding of the intent behind Section 1075 of the Act with regarding interchange fees. He noted that interchange fees are "a major source of paying for the administrative costs of prepaid cards used in connection with health care and employee benefits programs such as FSAs, HSAs, HRAs, and qualified transportation accounts" and made the point that "we do not wish to interfere with those arrangements in a way that could lead to higher fees being imposed by administrators to make up for lost revenue." His concern was that such a change could raise health care costs, which would hurt consumers.

Effective Date. The provisions relating to interchange fees require final rules be issued within nine months after the enactment date and are effective 12 months after the enactment date of the Consumer Financial Protection Act of 2010. **Sec. 1075 (p. 708)**.

8. Limitations on Payment Card Network Restrictions

No Exclusive Networks. Section 1075 of Dodd-Frank also amends Section 920 of the Electronic Fund Transfer Act to require the Fed to issue regulations providing that an issuer or payment card network may not restrict the number of payment card networks on which an electronic debit transaction may be processed to either a single network or two or more networks owned or controlled by affiliated persons. This must be done within one year of enactment. **Sec. 1075 (pp. 708-709)**. The Board must also regulate against routing restrictions within one year of enactment. **Sec. 1075 (p. 709)**.

Limitation on Restrictions on Offering Discounts for Payment Form. A payment card network may not inhibit the ability of any person to provide a discount or incentive for payment by the use of cash, checks, debit cards, or credit cards to the extent that the discount does not differentiate on the basis of the issuer or the payment card network, is offered to all prospective buyers and is clearly disclosed. **Sec. 1075 (p. 709)**.

Limitations on Restrictions on Setting Transaction Minimums or Maximums. A payment card network may not inhibit the ability of any person to set a minimum dollar value on the acceptance of credit cards to the extent the minimum does not differentiate between issuers or payment card networks and does not exceed $10 (which the Board may increase). **Sec. 1075 (p. 709-710)**.

I. Supervisory and Examination Authority

1. Reporting Requirements

A non-depository covered person who offers mortgage origination, brokerage, or servicing for use by consumers or is a large participant in the market for consumer financial products and services ("large participant" to be defined by rulemaking) would be subject to periodic reports and examinations by the Bureau under a risk-based supervision program. The risk-based supervision is based on the asset size of the covered person, its volume of transactions, and the risks to consumers created by its financial products. The Bureau would also have primary enforcement authority and exclusive rulemaking authority. **Sec. 1024(a)(1) (p. 622)**.

Banks with over $10 billion in assets would be subject to periodic reports and examinations by the Bureau. The Bureau would also have primary enforcement authority over banks with over $10 billion in assets. **Sec. 1025 (pp. 625-629)**. For banks with less than $10 billion in assets, the prudential regulator would have exclusive enforcement authority. **Sec. 1026 (pp. 629-630)**.

2. Examinations

The Bureau is directed to periodically require reports and conduct examinations to assess compliance with federal consumer financial law, obtain information about an institution's activities and compliance procedures, and detect risks to consumers. The Bureau also would have the authority to collect information regarding the organization, business conduct, and practices of covered persons in order to conduct research on the provision of consumer financial products or services. The supervisory program should be risk-based and take into consideration the asset size of the covered person, the volume of its transactions involving consumer financial products or services, the risks to consumers created by such financial products or services, and the extent to which such entities are subject to oversight by state authorities. **Sec. 1024(b)(1) (p. 623)**.

3. Conflicting Supervisory Determinations

To minimize regulatory burden, the Bureau is required to coordinate its supervisory activities with the activities of prudential regulators and State bank regulatory authorities and use existing reports to the fullest extent possible. **Sec. 1024(b)(3) and (4) (p. 623)**. If the proposed supervisory determinations of the Bureau and the prudential regulator conflict, the covered person may request a joint statement. **Sec. 1025(e)(3) (p. 627)**. If the conflict is not resolved, the covered person could appeal to a governing panel consisting of a representative from the Bureau, a representative of the prudential regulator, and, on a rotating basis, a representative from either the Fed, the FDIC, the National Credit Union Administration, or the OCC. **Sec. 1025(e)(4)(p. 628)**.

4. Illegal Acts

Under Title X, it would be unlawful for any person to:

i. Advertise, market, offer, or sell a consumer financial product or service not in conformity with this title or applicable rules or orders issued by the Bureau;

ii. Enforce, or attempt to enforce, any agreement with a consumer, or impose any fee or charge in connection with a consumer financial product or service that is not in conformity with this title or applicable rules or orders;

iii. Engage in any unfair, deceptive, or abusive act or practice;

iv. Advertise, market, offer, sell, enforce, or attempt to enforce, any term, agreement, change in terms, fee or charge in connection with a consumer financial product or service that is not in conformity with this title or applicable rules or orders;

v. Engage in any unfair, deceptive, or abusive act or practice; or

vi. Fail or refuse to permit access to or copying of records. **Sec. 1034 (pp. 644-645)**.

J. Enforcement Authority

1. General Enforcement Authority

To the extent that federal law authorizes both the Bureau and another federal agency to enforce federal consumer financial law with regard to a non-depository person, the Bureau will have exclusive authority. To the extent that federal law authorizes both the Bureau and another Federal agency to enforce federal consumer financial law with regard to an insured depository institution with over $10 billion in assets, the Bureau will have primary enforcement authority. **Sec. 1024(c)(1) (p. 624)**.

Any Federal agency could recommend to the Bureau, in writing, that the Bureau initiate a enforcement proceeding. If the Bureau fails to do so within 120 days, the other agency would be authorized to initiate a proceeding to the extent permitted by law. **Sec. 1024(c)(2) (p. 624)**.

The enforcement and regulatory authority under the Federal Trade Commission Act (the "FTC Act") will be preserved following creation of the Bureau. The FTC and the Bureau must enter into a memorandum of understanding and coordinate their regulatory efforts to ensure that businesses are not subject to overlapping/dual regulations. **Sec. 1024(c)(3) (pp. 624-625)**.

2. Enforcement Authority for Small Banks, Thrifts, and Credit Unions Under $10 Billion

Pursuant to the Act, the prudential regulator will have exclusive authority to bring enforcement actions against institutions with less than $10 billion in assets. The Bureau may notify the prudential regulator of any violations, and the prudential regulator must respond to the Bureau within sixty days. **Sec. 1026(d) (p. 630)**.

3. Joint Investigations and Civil Investigative Demands

The Bureau can engage in joint investigations and requests for information with the Secretary of Housing and Urban Development (the "HUD Secretary"), the Attorney General, or both. Bureau investigators will have the authority to issue subpoenas requesting testimony or the production of materials, which are enforceable in federal district court. If the Agency has reason to believe that a person has documentary material or any information relevant to a violation, the Agency could issue a civil investigative demand. If a person fails to comply with a civil investigative demand, the Bureau could file a petition for an order of enforcement in federal district court. **Sec. 1052 (pp. 655-661).**

4. Administrative Proceedings

The Bureau can conduct hearings and adjudication proceedings, including cease-and-desist proceedings, to enforce compliance with Title X and any issued regulations, or any other federal law that the Bureau is authorized to enforce. **Sec. 1053 (pp. 661-664)**.

5. Civil Actions

The Bureau can also bring a civil action or seek civil penalties and equitable relief for violations of Title X, related regulations, or other consumer financial protection laws. When commencing a civil action, the Bureau must notify the Attorney General. **Sec. 1054 (pp. 664-665)**.

6. Relief Available

In an administrative proceeding or court action, the Bureau may seek specific forms of relief including the rescission or reformation of contracts, refund of money or return of real property, restitution, disgorgement for unjust enrichment, payment of damages, public notification of the violation and related costs, limits on the entity's activities or functions, or civil penalties. Exemplary or punitive damages are not permitted. The Bureau, state attorney general, or state regulator could recover the costs it incurred in connection with the action if it is the prevailing party. **Sec. 1055 (pp. 665-667)**.

First tier civil penalties would be limited to $5,000 for each day during which the violation continues. Second tier civil penalties, available when a person recklessly engages in a violation, would be limited to $25,000 for each day during which the violation continues. Third tier civil penalties, imposed for knowing violations, could not exceed $1,000,000 for each day during which the violation continues. The penalty would be required to reflect the size of financial resources and good faith of the person charged, the gravity of the violation, the severity of risks or losses to the consumer, any history of previous violations, and "such other matters as justice may require." The Agency could also make referrals for criminal proceedings to the Attorney General whenever the Agency obtains evidence that a person has engaged in conduct that may constitute a violation of federal criminal law. **Sec. 1055(c) (p. 666)**.

All civil penalties would be placed in the Victims Relief Fund. **Sec. 1017(d)(1) (p. 614)**.

K. Whistleblower Protection

Title X provides whistleblower protection in so far as a covered person or service provider is prohibited from terminating or discriminating against a covered employee because that employee has provided information to the agency or any other state, local, or federal entity. Likewise, an employee could not be terminated or discriminated against because he or she objected to or refused to participate in any activity, policy, practice, or assigned task that the employee reasonably believed to be in violation of any law, or constitute an unfair, deceptive, or abusive practice. **Sec. 1057 (pp. 667-671)**.

L. Transfer of Other Consumer Financial Protection Functions to the Agency

Consumer financial protection functions of the Fed, OCC, OTS, FDIC, NCUA, Department of Housing and Urban Development ("HUD"), and FTC would be transferred to the Bureau subject to backup enforcement authority. **Sec. 1061(b) (pp. 672-674)**.

M. Preemption Provisions of Title X (Subtitle D)

1. Preemption Framework Under the Dodd-Frank Act

Subtitle D of Title X, effectively supplants the existing regime of "complete" preemption, under which all state laws that "touch upon" the business of banking are preempted,[38] with a

[38] In *Barnett Bank v. Nelson*, the Supreme Court held that a federal statute permitting national banks in small towns to sell insurance preempted a state law prohibiting national

[Footnote continued on next page]

milder form of "conflict" preemption, in which only conflicting state laws are preempted.[39] Title X makes explicit that the Act does not occupy the field in any area of state law. Courts finding preemption must make a *de novo* finding that federal law provides a substantive standard governing the particular conduct at issue. The Act states that, except as otherwise provided in this Title, federal law "may not be construed as annulling, altering, or affecting" state law unless the state law "is inconsistent with the provisions of this Title and then only to the extent of the inconsistency." State law is not inconsistent if it affords consumers greater protection than federal law.[40] Determination of inconsistency "may be made by the Bureau on its own motion or in response to a non-frivolous petition initiated by any interested person." **Sec. 1041(a) (p. 647)**.

2. Preemptive Effect of Federal Consumer Financial Protection Regulations

The preemptive effect of "any provision of any enumerated [federal] consumer law that relates to the application of a law in effect in any State with respect to such Federal law" is preserved. **Sec. 1041(b) (p. 647)**. Subtitle D does not explicitly specify whether regulations interpreting such federal consumer laws will be preserved.

The Bureau is authorized to issue regulations to implement Title X. In addition, the Bureau will be required to issue a notice of proposed rulemaking when the majority of states enact a resolution supporting a consumer protection regulation. Subtitle D does not explicitly specify the preemptive effect of the Bureau's regulations, but it appears that the conflict preemption standards applied to the substantive provisions of Title X would also apply to the Bureau's regulations.

In prescribing a final regulation in response to a state-initiated action, the Bureau will

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[Footnote continued from previous page]

banks from doing so. 517 U.S. 25 (1996). In *Watters v. Wachovia Bank*, the Supreme Court held that a national bank, which is subject to supervision by the Office of the Comptroller, was not subject to the visitorial powers of the states. 550 U.S. 1 (2007).

39 *See*, *e.g.*, *Geier v. Am. Honda Motor Co.*, 529 U.S. 861 (2000) (holding that an action under D.C. tort law against an automobile manufacturer asserting negligence for failure to provide airbags was preempted because it actually conflicted with a Department of Transportation standard).

40 This form of preemption follows *Fla. Lime & Avocado Growers v. Paul*, in which the mere existence of a less restrictive federal law in the same arena did not raise a preemptive conflict. Under the *Fla. Lime* standard, state law is not preempted unless it is "physically impossible" to comply with both state and federal law. 373 U.S. 132 (1963).

consider whether the proposed regulation will afford greater consumer protection than existing regulations, whether the benefits outweigh increased costs and inconveniences to consumers, whether the regulation could lead to any unfair discrimination, and whether any federal banking Bureau has determined that the proposed regulation would present an unacceptable safety and soundness risk to insured depository institutions. If the Bureau enacts a regulation, it is required to publish a discussion of its considerations in the Federal Register notice of the final regulation. If the Bureau decides not to issue a regulation, it must publish an explanation of its determination in the Federal Register and provide copies to each state enacting a resolution in favor of the regulation, the House Financial Services Committee, and the Senate Banking Committee. **Sec. 1041(c) (pp. 647-48)**.

Subtitle D explicitly preserves existing contracts by stating that the statute and implementing regulations "shall not be construed to alter or affect the applicability of any OCC or OTS regulation regarding the applicability of state law under federal banking law to any contract entered into on or before the date of the enactment of this Title." **Sec. 1043 (p. 650)**. Section 1043 preserves extant OCC and OTS regulations insofar as they apply to pre-enactment contracts, but does not indicate whether OCC and OTS regulations will remain valid with regard contracts entered into after the effective date of the Act.

3. Preemption Standards for National Banks and Federal Savings Associations

Subtitle D provides an explicit framework for determining preemption of state consumer financial laws that relate to national banks. With regard to national banks, state consumer financial law is preempted only if (1) its application would have a discriminatory effect on national banks as compared to state-chartered banks; (2) it is determined (by a court or the Comptroller) to run afoul of the *Barnett Bank* preemption standard; or (3) it is preempted by another federal law. **Sec. 1044(a) (p. 650)**.

The *Barnett Bank* standard codified in prong (2) above is a stringent test, preempting only state consumer financial laws that prevent or significantly interfere with the exercise of a national bank's powers. To make a finding of preemption, the Comptroller must make a case-by-case determination in consultation with the Bureau. OCC preemption determinations must be made public, submitted to Congress, and periodically reviewed by the Comptroller. **Sec. 1044(b) (pp. 650-52)**. This "case-by-case" requirement calls into question some of the OCC's existing regulations, which determine that certain categories of state law conflict with federal law. Federal courts finding preemption must make a *de novo* finding that federal law provides a substantive standard governing the particular conduct at issue.

Under its savings clause, the statute "does not preempt, annul, or affect the applicability of any State law to any subsidiary or affiliate of a national bank (other than a subsidiary or affiliate that is chartered as a national bank." **Sec. 1044(b)(2) (p. 651)**. Section 1045 further clarifies that no provision of this Title may be construed as preempting, annulling, or affecting the applicability of State law to any nondepository subsidiary, affiliate, or agent of a national bank. **Sec. 1045 (p. 653)**. This section would effectively overrule *Watters* by making state law applicable to non-depository subsidiaries even if that same law would be preempted if applied to a national bank parent.

Section 1046 applies parallel provisions to federally chartered savings associations.

4. Preservation of Enforcement Powers of States

Title X permits state attorneys general to sue in federal or state court to enforce and secure remedies under provisions of this Title or regulations issued thereunder, or otherwise provided under other law. **Sec. 1042(a) (pp. 648-49)**. State attorneys general must notify the Bureau and prudential regulator of any action to enforce any provision of this Title or any regulation issued thereunder, and the Bureau may intervene in such an action. If emergency action is necessary, the state attorney general must notify the Bureau immediately upon commencing the action. **Sec. 1042(b) (p. 649)**. The Director will issue regulations to implement this section and provide guidance for the coordination of action with state regulators. **Sec. 1042(c) (p. 649)**.

However, state attorneys general may bring suit against a national bank or federal savings association only to enforce a regulation prescribed by the Bureau under a provision of Title X and to secure remedies under provided under title X or other law. **Sec. 1042(a)(2)(B) (pp. 648-49)**. State attorneys general may not otherwise bring a civil action against a national bank or federal savings association with respect to an act or omission that would be a violation of a provision of Title X. **Sec. 1042(a)(2)(A) (p. 648)**.

Section 1042 specifies that no provision of this section should be construed as limiting the authority of a state attorney general or state regulator to bring an action or other regulatory proceeding arising solely under the law of that state. Section 1042 expands upon *Cuomo v. Clearing House* by broadly authorizing state officials to enforce not only state law, but all the provisions of "this Title," including regulations issued under this Title. By giving the Bureau discretionary authority to intervene, this provision recognizes concurrent federal-state authority (rather than exclusive federal authority). **Sec. 1042(d) (pp. 649-50)**.

Furthermore, the statute will not affect the authority of a state securities commission or state insurance commission to take any action under state law with respect to a regulated person. As a result, state securities and insurance laws may *never* be preempted by the federal banking laws, even if there is an actual conflict. **Sec. 1042(d) (pp. 649-50)**.

5. Visitorial Standards

Visitorial powers[41] provisions of Title X do not limit the authority of a state attorney

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[41] Under the National Bank Act, visitation refers to government supervisory powers over corporations. *Cuomo v. Clearing House Ass'n*, 129 S. Ct. 2710, 2721 (2009).

general to bring an action to enforce any applicable federal or state law, after consultation with the appropriate federal agency. State attorneys general may also seek "relief" authorized by federal or nonpreempted state law. The ability of federal officials to bring an enforcement action "shall not be construed as precluding private parties from enforcing rights granted under Federal or State law in the courts." **Sec. 1047 (p. 654)**.

Section 1047 essentially codifies the *Cuomo* decision by stating that the "visitorial powers" under federal law do not preclude state enforcement actions (although state officials are now required to consult with the appropriate federal agency). The additional authorization for state officials to seek "relief" authorized by nonpreempted state law may indicate that damages or other monetary claims (including claims where the attorney general sues on behalf of individual citizens) could be permitted. The statement that private parties are not precluded from "enforcing rights granted" could lead to litigation over whether or not Congress intended to imply any private rights of action.

TITLE XI: Federal Reserve System Provisions

A. Amendments to the Fed's Emergency Lending Authority

1. Emergency Lending by the Fed Under Section 13(3)

Title XI amends Section 13(3) of the FR Act, which allows the Fed to lend "under unusual and exigent" circumstances to companies that are not depository institutions. Under this current law, in unusual and exigent circumstances, the Fed may authorize a Reserve Bank to provide emergency credit to individuals, partnerships, and corporations that are not depository institutions. Such lending may occur only when, in the judgment of the Reserve Bank, credit is not available from other sources and failure to provide credit would adversely affect the economy. Specific approval by the Fed is required.

The Fed used this authority in several programs and actions taken during the fall of 2008, including to provide financial assistance to American International Group and to establish the Term Asset Backed Securities Loan Facility ("TALF"), Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility ("AMLF"), and Commercial Paper Funding Facility ("CPFF"). The Federal Reserve declined to use its Section 13(3) authority to assist Lehman Brothers.

The Act amends Section 13(3) of the FR Act to provide that the Fed may authorize such emergency credit to a participant in any program or facility with broad-based eligibility. Further, the Act requires the Fed to establish, by regulation and in consultation with the Secretary, the polices and procedures governing emergency lending under Section 13(3). Such policies and procedures are required to ensure that the purpose of the emergency lending program is providing liquidity to the financial system and not to aid a failing financial company and that the collateral for emergency loans is of sufficient quality to protect taxpayers from losses. The Fed will not be permitted to establish an emergency lending program without prior approval from the Secretary. **Sec. 1101 (pp. 750-753)**.

2. Reports by the Fed to Congress

The Fed must provide a report to the Senate Banking Committee and the House Financial Services Committee containing:

i. The justification for the exercise of the Fed's authority to provide emergency assistance;

ii. The identity of the recipients of such assistance;

iii. The date and amount of the assistance and the form in which it was provided; and

iv. The material terms of the assistance (including duration, collateral pledged, interest and fees collected) and requirements imposed.

Once every thirty days, the Fed is required to provide written updates with respect to outstanding loans or financial assistance, which detail the value of the collateral, the amount of interest and fees received, and the expected or final cost to taxpayers. **Sec. 1101 (pp. 750-753).**

Upon written request of the Fed Chairman, however, the Fed may keep confidential the identity of participants in an emergency lending program, the amounts borrowed, and identifying details concerning assets or collateral held in connection with such lending facility. In these cases, such information will be made available only to the Chairs and Ranking Members of Senate Banking Committee and House Financial Services Committee. **Sec. 1101 (pp. 750-753).**

B. GAO Audits of Special Federal Reserve Credit Facilities

Under the Act, the GAO is authorized to conduct audits, including onsite examinations of the Fed, a Federal Reserve Bank, or a credit facility if the GAO determined such an audit was appropriate for assessing the operational integrity, effectiveness, and fairness of such a credit facility or covered transaction. A "credit facility" is defined as any utility, facility, or program authorized by the Fed under Section 13(3) of the FR Act. A "covered transaction" is defined as any open market transaction the Fed conducts with a private third party under Section 14 of the FR Act or a discount window advance under Section 10B of the FR Act. **Sec. 1102 (pp. 753-755)**.

1. Reporting Requirements

The GAO is required to submit reports on such audits to the Congress within 90 days of completing the audit. The report must include a detailed description of the findings and conclusions of the GAO as well as recommendations for legislative or administrative action as appropriate. The GAO may not disclose the names or identifying details of specific participants in any credit facility and the report would be redacted to ensure that names and details are not disclosed. However, if the Fed has publicly disclosed such details, then the GAO's non-disclosure obligation will not apply. Additionally, the GAO will be required to release a non-redacted version of the report one year after the Fed has terminated the authorization for the credit facility. If a credit facility's authorization has not yet expired and the Fed has not yet formally terminated the facility, such facility will be deemed terminated two years after the date on which the facility ceases to make extensions of credit and loans. **Sec. 1102 (pp. 753-755)**.

2. Public Access to Information

The Act amends Section 2B of the FR Act to require that the Fed make such information publicly available, including the reports prepared by the GAO, the annual financial statements prepared by an independent auditor of the Fed, and the reports provided to Congress regarding the emergency lending authority, as well as any other information the Fed believes is necessary or helpful to the public. **Sec. 1103 (pp. 755-757)**.

The Act also amends Section 11 of the FR Act to require the Fed to disclose, with respect to credit facilities and covered transactions, the:

- Identity of the borrower, participant, or counterparty;

- Amount borrowed;
- Interest rate or discount paid by the borrower, participant, or counterparty; and
- Information identifying the types and amounts of collateral pledged or assets transferred in connection with participation in a credit facility or covered transaction.

For credit facilities, the Fed must disclose the above information about participants in the program one year after the termination of the credit facility. For covered transactions, the Fed must disclose details about counterparties to such transactions two years after the transaction was conducted. The Fed Chairman may release this information to the public earlier if he determines that such disclosure would be in the public interest and would not harm the effectiveness of the credit facility or the purpose of the covered transactions. Such information is also protected from FOIA disclosure until it is released in accordance with this provision. The provision, however, requires the Fed's Inspector General to submit a report to the House Financial Services Committee and the Senate Banking Committee about the impact of the FOIA exemption on the public's ability to access information on emergency credit facilities and open market operations. **Sec. 1103 (pp. 755-757)**.

C. GAO Audit of Fed

The Act requires the GAO to conduct a single, limited, independent audit of the Fed. This one time audit contrasts with an alternative proposal that would have subjected the Fed to perpetual GAO audits. **Sec. 1109 (pp. 764-766)**.

D. FDIC Emergency Financial Stabilization Program

1. Liquidity Event Determination

The Act establishes parameters under which the FDIC will be allowed to create an emergency financial stabilization program. First, the FDIC and the Fed must determine whether a liquidity event exists, which requires a vote of at least two-thirds of the members of each institution. The determination must include an evaluation of the evidence that a liquidity event exists, that a failure to take action would have serious adverse effects on financial stability or economic conditions in the United States, and that an emergency financial stabilization program is needed to avoid or mitigate potential adverse effects on the U.S. financial system. **Sec. 1104(a-b) (pp. 757-758)**.

The Secretary also must provide his or her written consent, as well as maintain written documentation for each determination and provide this documentation to the GAO for its review. The GAO must review and report to Congress on any liquidity event determination, including the basis for the determination and the likely effect of the actions taken. **Sec. 1104(c) (p. 758)**.

For the purposes of this section, a "liquidity event" is defined as either: (1) an exceptional and broad reduction in the general ability of financial market participants to sell a type of financial asset without a significant reduction in price or to borrow using that asset as collateral without a significant increase in margin; or (2) an unusual and significant reduction in the usual ability of financial and nonfinancial market participants to obtain unsecured credit.

Sec. 1105(g)(3) (p. 762).

2. Creation of Emergency Financial Stabilization Program

Upon such a determination, the FDIC will be authorized to create a widely available program to guarantee obligations of solvent insured depository institutions or solvent depository institution holding companies if necessary to prevent systemic financial instability during times of severe economic distress. Such guarantees, however, may not include the provision of equity in any form. **Sec. 1105(a) (p. 758)**. As soon as practicable, the FDIC must establish by regulation, with the concurrence of the Secretary, policies and procedures governing the issuance of these guarantees. **Sec. 1155(c) (pp. 758-759)**.

3. Maximum Debt Guaranteed

The Secretary, in consultation with the President, determines the maximum amount of debt outstanding that the FDIC will be allowed to guarantee under this program. The President must then transmit a plan with the maximum delineated guarantee amount to Congress, which would then consider the plan under a fast-track procedure and pass a joint resolution approving the plan before it may take effect. **Sec. 1105(c)(1) (pp. 758-759)**. If the Secretary, in consultation with the President, determines that the maximum guarantee amount should be raised, and the FDIC concurs, then the President can transmit a written report to Congress about the plan to issue guarantees up to the increased maximum debt guarantee amount. Again, Congress must consider the President's request under a fast-track process and pass a joint resolution of approval before the increased guarantees may take effect. **Sec. 1105(c)(2) (p. 759)**. The procedures governing fast-track consideration of the President's requests are outlined in Dodd-Frank. **Sec. 1105(d) (pp. 759-761)**.

4. Funding

The FDIC must charge fees and other assessments to all participants in the program in amounts necessary to offset projected losses and administrative expenses. If such fees are insufficient, the FDIC is permitted to impose a special assessment on participants in the program. If there are excess funds at the conclusion of the program, the funds would be deposited in the General Fund of the Treasury. **Sec. 1105(e) (pp. 761-762)**.

The FDIC is also authorized to borrow funds from the Secretary of the Treasury and issue obligations of the FDIC to the Secretary for amounts borrowed in order to carry out a financial stabilization program. The obligations issued <u>must</u> be repaid in full with interest through fees and charges paid by participants. The Secretary may purchase any obligations so issued. **Sec. 1105(e) (pp. 761-762)**.

E. Additional Related Amendments

1. Suspension of Parallel FDI Act Authority

Upon enactment, the FDIC would be prohibited from exercising its authority under Section 13(c)(4)(G)(i) to establish any widely available debt guarantee program, such as that provided for under Section 1105 of the Act. **Sec. 1106(a) (pp. 762-763)**.

2. Effect of Default on an FDIC Guarantee

If an insured depository institution or depository institution holding company participating in the emergency stabilization program defaults on any obligation guaranteed by the FDIC, the FDIC could appoint itself as receiver for the insured depository institution that defaults. With respect to a participating company that is not an insured depository institution and defaults, the FDIC could require consideration of whether a determination may be made under Section 203 to resolve the company under Section 202 (the provisions concerning enhanced dissolution authority). If the FDIC is not appointed receiver pursuant to Title II within 30 days of default, the FDIC could require the company to file a petition for bankruptcy under Section 301 of the Code, which is amended to allow for such an involuntary petition for bankruptcy. **Sec. 1106(c) (pp. 762-763)**.

F. Federal Reserve Bank Governance and Supervision

Currently, all members of the Board of Directors of a regional Federal Reserve Bank may vote in selecting the Federal Reserve Bank president. The Act permits only Class B and Class C directors to vote. Class A directors, who are selected by member banks to represent member bank interests, will not be permitted to participate in the selection of a Federal Reserve Bank president. **Sec. 1107 (p. 763)**.

Further, the Act would establish the position of Vice Chairman for Supervision at the Fed. The Vice Chairman of Supervision would be responsible for developing policy recommendations for the Fed regarding supervision and regulation of depository institution holding companies and other financial firms supervised by the Fed, and would oversee the supervision and regulation of such firms. The Vice Chairman would be required to appear before the Senate Banking Committee and House Financial Services Committee at annual hearings. Additional amendments are made to the FR Act stating that the Fed may not delegate its functions regarding the supervision and regulation of depository institution holding companies and other financial firms to a Federal Reserve Bank. **Sec. 1108 (pp. 763-764)**.

TITLE XII: Improving Access to Mainstream Financial Institutions

Introduction

Title XII's stated purpose is "to encourage initiatives for financial products and services that are appropriate and accessible for . . . Americans who are not fully incorporated into the financial mainstream." **Sec. 1202 (p. 767)**. In order to accomplish this, Title XII increases the availability and ease of access to federally insured depository institutions and accounts among low- and moderate-income individuals. **Sec. 1204(a) (pp. 767-768)**. Further, it establishes low-cost, small loans for consumers who currently face only high cost options for such loans. **Sec. 1205 (p. 768).** The title authorizes the Secretary to establish grant and demonstration programs to encourage the participation of depository institutions and community development institutions in these endeavors. **Sec. 1206 (pp. 768-769)**.

A. Expanded Access to Mainstream Financial Institutions

The Secretary is authorized to establish a multiyear program of grants, cooperative agreements, financial agencies agreements and other undertakings with the purpose of enabling low- and moderate-income individuals to establish accounts in a federally insured depository institution and improving access to the provision of such accounts on reasonable terms for these individuals. **Sec. 1204(a) (pp.767-768)**.

Participation in these programs is limited to "eligible entities" which include: 501(c)(3) organizations; federally insured depository institutions; community development financial institutions; State, local or tribal government entities; and partnerships or joint ventures comprised of any of these institutions. **Sec. 1204(b) (p. 768).**

Eligible entities participating in this these programs may provide products and services to low- and moderate-income persons, including small-dollar value loans and financial education and counseling relating to conducting transactions and managing accounts. **Sec. 1204(b) (p. 768)**.

B. Low Cost Alternatives to Small-Dollar Loans

The Secretary is also authorized to establish multiyear demonstration programs to provide low-cost, small loans to consumers as an alternative to more costly small-dollar loans. **Sec. 1205(a) (p. 768)**.

Loans under this section must be made on terms and conditions and pursuant to lending practices that are reasonable for borrowers. Eligible entities must promote and take steps to ensure the provision of financial literacy education to each borrower provided with a loan pursuant to this section. **Sec. 1205(b) (p. 768)**.

C. Grants to Establish Loan-Loss Reserve Funds

The Community Development Banking and Financial Institutions Act of 1994 (12 U.S.C. 4701 et seq.) is amended to direct the Community Development Financial Institutions Fund to make grants to community development financial institutions and other depository institutions to enable them to establish a loan-loss reserve fund in order to defray the costs of a small-dollar loan program established or maintained by the institution. **Sec. 1206 (pp. 768-769)**.

Community development financial institutions and other depository institutions are required to provide non-federal matching funds equal to 50% of the grant received. Grants received under this section may not be used to provide direct loans, but they may be used to help recapture a defaulted loan made under the small-dollar loan program and may be used to employ a fiscal agent for their normal service. **Sec. 1206 (p. 769)**.

The Community Development Financial Institutions Fund must also make technical assistance grants to community development financial institutions and other depository institutions, which may be used for technology, staff support, and other costs associated with establishing a small-dollar loan program. **Sec. 1206 (p. 769)**.

D. Regulations

The Secretary is authorized to issue regulations to implement and administer the grant programs and undertakings authorized by the title. Regulations issued under this section may classify, differentiate, adjust, or exempt any class of grant programs, undertakings, or eligible entities that in the judgment of the Secretary are necessary or proper to effectuate the purposes of, to prevent circumvention of, or to facilitate compliance with this title. **Sec. 1209 (p. 770)**.

E. Evaluation and Reports to Congress

For each fiscal year in which a program or project is carried out under this title, the Secretary must submit a report to the Senate Committee on Banking, Housing, and Urban Affairs and the House of Representative Committee on Financial Services, describing the activities funded, amounts granted, and measurable results, as available. **Sec. 1210 (p. 770)**.

TITLE XIII: Pay It Back Act

Title XIII provides a framework for paying back the taxpayers for federal moneys expended as part of the Emergency Economic Stabilization Act of 2008 (the "EESA") and reducing the cap on Troubled Asset Relief Program ("TARP") purchasing authority. It may be cited as the Pay It Back Act. **Sec. 1301 (p. 770)**.

A. Amendment to Reduce TARP Authorization

Title XIII amends the EESA by reducing the amount available for borrowing from $700 billion to $475 billion. **Sec. 1302 (p. 770)**. The amount considered to be exercised by the Secretary cannot be offset or reduced by any amounts received by the Secretary from repayment of financial assistance by an entity that has received TARP assistance, any amounts committed for TARP that became or become uncommitted, or any losses realized by the Secretary. **Sec. 1302 (p.770)**. The Pay It Back Act also revokes authorization for any EESA programs not yet commenced on June 25, 2010. **Sec. 1302 (pp. 770-771)**.

B. Report

The title requires the Secretary to report to Congress every six months on any amounts received under EESA Subsection (d) and transferred to the General Fund. **Sec. 1303 (p. 771)**.

C. Amendments to Housing and Economics Recovery Act of 2008

Title XIII also requires any funds received from the sale of obligations and securities of Fannie Mae, Freddie Mac, or Federal Home Loan Banks to be dedicated for the purpose of deficit reduction. **Sec. 1304 (pp. 771-772)**. The Act further prohibits any amounts received from the sale of such obligations or securities from use as an offset for other spending increases or revenue reductions. **Sec. 1304 (pp. 771-772)**. Further, any fee or assessment paid by Fannie Mae or Freddie Mac to the Secretary as a result of a preferred stock purchase agreement, mortgage-backed security purchase program, or any other program authorized under Section 1117 of the Housing and Economic Recovery Act of 2008 must be dedicated to the sole purpose of debt reduction and is prohibited from use as an offset for other spending measures. **Sec. 1304(d) (p. 772)**.

D. Federal Housing Finance Agency Report

The Act requires the Director of the Federal Housing Finance Agency to submit a report to Congress that explains the Agency's plans to continue to support and maintain the nation's housing industry while shielding taxpayers from unnecessary losses. **Sec. 1305 (p. 772)**.

E. Repayment of Unobligated American Recovery and Reinvestment Act Funds

Any American Recovery and Reinvestment Act (the "ARRA") funds provided to any state that are not accepted for use by the governor or legislature of that state will be rescinded and deposited in the General Fund of the Treasury where they are to be used for deficit reduction and prohibited from being used to offset other spending. **Sec. 1306(a) (p. 772)**. Title XIII further amends ARRA to require that the head of any executive agency that withdraws or recaptures funds appropriated or made available under ARRA that have not been obligated to a state or local government, must rescind such funds and deposit them in the Treasury's General Fund for deficit reduction. **Sec. 1306(b) (pp. 772-773)**. Finally, the Act requires that any discretionary appropriations made available under Section 1603 of ARRA that have not been obligated by December 31, 2012 are to be rescinded and any amounts deposited in the General Fund of the Treasury where they are to be dedicated for the purpose of deficit reduction and prohibited from use as an offset for spending increases or revenue reductions. **Sec. 1306(c) (p. 773)**.

The Act permits the President to waive any repayment requirements if the President determines that it is not in the best interests of the Nation to rescind a specific unobligated amount. **Sec. 1306(c) (p. 773)**. The head of an executive agency may also apply to the President for a waiver of the requirements mandating rescission of funds. **Sec. 1306(c) (p. 773)**.

Because the Act does not specify when Title XIII becomes effective, the effective date is one day after enactment. **Sec. 4 (p. 16)**.

TITLE XIV: Mortgage Reform and Anti-Predatory Lending Act

Title XIV's short title is the "Mortgage Reform and Anti-Predatory Lending Act." **Sec. 1400(a) (p. 773)**.

Subtitles A, B, C, and E, as well as Sections 1471, 1472, 1475, and 1476 are under the purview of the Bureau. **Sec. 1400(b) (p. 773)**.

Regulations required under Title XIV must be in final form within 18 months of the transfer date and must take effect no later than 12 months after the date of their issuance. The title's sections take effect when the final regulations implementing the sections take effect. If regulations have not been issued within 18 months of the designated transfer date for a section, however, then the section will take effect on that date. **Sec. 1400(c) (pp. 773-774)**.

A. Residential Mortgage Loan Origination Standards

1. Definition of Mortgage Originator

A "mortgage originator" is defined as "any person who, for direct or indirect compensation or gain . . . (i) takes a residential loan application; (ii) assists a consumer in obtaining or applying to obtain a residential mortgage loan; or (iii) offers or negotiates terms of a residential mortgage loan." The definition also includes anyone who represents to the public that it can provide any of the aforementioned services. It specifically excludes persons who perform clerical tasks and employees of manufactured home retailers who do not advise consumers on loan terms, persons that only perform real estate brokerage activities, and mortgage servicers. **Sec. 1401 (p. 774)**.

2. Residential Mortgage Loan Origination

Title XIV amends the TILA by adding a section regarding residential mortgage loan origination. The amendment is based on Congress's finding that regulation of residential mortgage credit and practices will enhance economic stabilization. The purpose of the section is to ensure that consumers are offered and receive mortgage loans that they can repay reasonably and that are understandable. **Sec. 1402 (p. 776)**.

Mortgage originators must be qualified and, when required, be registered and licensed in accordance with applicable state and federal law. Mortgage originators must include on all loan documents any unique identifier provided by the Nationwide Mortgage Licensing System and Registry. Additionally, the Fed must prescribe regulations to require depository institutions to establish procedures to assure and monitor compliance of the institutions, their subsidiaries, and employees. **Sec. 1402 (p. 776)**.

3. Prohibition on Steering Incentives

Mortgage originators are prohibited from receiving compensation that varies based on the terms of the loan, other than the principal amount, i.e., steering incentives. Only consumers may pay a mortgage originator any origination fee, unless the mortgage originator does not receive any compensation from the consumer and the consumer does not make an upfront payment. **Sec. 1403 (pp. 776-777)**.

The Fed must prescribe regulations to prohibit mortgage originators from steering consumers to residential mortgage loans that the consumer lacks a reasonable ability to repay or that have predatory characteristics. The Fed also must prohibit: mortgage originators from steering consumers away from qualified mortgages to unqualified mortgages; abusive or unfair lending practices that promote disparities among consumers of equal creditworthiness but of different race, gender, age, or ethnicity; and mortgage originators mischaracterizing consumers' credit histories and the appraised value of a property. **Sec. 1403 (pp. 777-778)**.

4. Liability

The maximum liability of a mortgage originator for failing to comply with this section must not exceed the greater of actual damages or three times the total amount of direct or indirect compensation or gain accruing to the mortgage originator in connection with the mortgage involved in the violation, plus the cost to the consumer, including reasonable attorneys' fees. **Sec. 1404 (p. 778)**.

5. Regulations

The Fed must, by regulations, prohibit residential mortgage terms, acts, or practices it finds to be abusive. The prohibitions apply to all residential mortgages, though the Fed may modify disclosure requirements for any class of residential mortgages if the Fed determines that the modification is in the interest of consumers and the public. **Sec. 1405 (pp. 778-779)**.

6. Study of Shared Appreciation Mortgages

The HUD Secretary, in consultation with the Treasury Secretary and other relevant agencies, must conduct a study to determine prudent requirements to provide for the widespread use of shared appreciation mortgages. They must submit a report to Congress within six months of the date of enactment. **Sec. 1406 (p. 779)**.

B. Minimum Standards for Mortgages

1. Ability to Repay

Before making a residential mortgage loan, creditors must make a "reasonable and good faith determination based on verified and documented information" that the consumer has a reasonable ability to repay the loan, along with all applicable taxes, insurance, and assessments. If the creditor knows or has reason to know that a consumer has secured one or more residential loans with the same dwelling, the creditor must make a "reasonable and good faith determination" that the consumer has a reasonable ability to repay the combined payments on all of the loans.

To make these determinations, creditors must consider the consumer's credit history, current income, expected income, current obligations, debt-to-income ratio, employment status, and the consumer's financial resources other than the consumer's equity in the dwelling or real property that secures the mortgage. Creditors must assess the consumer's ability to repay using a fully amortizing payment schedule. Creditors must verify the consumer's income by reviewing the consumer's IRS Form W-2, tax returns, payroll receipts, bank records, or other third-party documents.

To determine a consumer's ability to repay a variable rate loan, creditors must use a fully amortizing repayment schedule. For interest-only loans, creditors must use the payment amount required to amortize the loan by its final maturity. Creditors must also consider any balance increase that may accrue from negative amortization provisions.

In making its calculations under this section, a creditor must calculate the monthly payment amount for principal and interest on any residential mortgage loan by assuming: (i) the loan proceeds are fully disbursed on the date of the loan; (ii) the loan is to be repaid in substantially equal monthly payments for principal and interest over the entire term of the loan with no balloon payment; and (iii) the interest rate over the entire term of the loan is a fixed rate equal to the fully indexed rate at the time of the loan closing, i.e., the index rate prevailing on a residential mortgage loan at the time the loan is made plus the margin that will apply after the expiration of introductory interest rates.

If a creditor is considering refinancing an existing hybrid loan to a standard loan to be made by the same creditor, the mortgagor has not been delinquent on payments on the hybrid loan, and the monthly payment would decrease, the creditor may consider the mortgagor's good standing on the existing mortgage, whether the extension of new credit would likely prevent a default and offer favorable terms that would be available to new customers with high credit ratings.

This section must not apply to any reverse mortgage or temporary bridge loan with a term of 12 months or less.

If documented income, including a small business, is a source for repayment of a residential mortgage, a creditor may consider the irregularity of the income in the underwriting and scheduling of payments for the mortgage. **Sec. 1411 (pp. 779-782)**.

2. Safe Harbor and Rebuttable Presumption

A "qualified mortgage" is any residential mortgage that:

i. The regular payments of which do not: (i) result in an increase of the principal balance; or (ii) allow the consumer to defer repayment of the principal;

ii. Does not result in a balloon payment, i.e., a scheduled payment that is more than twice as large as the average of earlier scheduled payments;

iii. Is qualified by income and financial resources that are verified and documented;

iv. For a fixed rate loan, is based on a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments;

v. For an adjustable rate loan, is based on the maximum rate permitted under the loan during the first 5 years, and a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments;

vi. Complies with any guidelines or regulations established by the Fed;

vii. Has total points and fees that do not exceed 3 percent of the total mortgage amount;

viii. The term of which does not exceed 30 years; and

ix. For a reverse mortgage, meets all the standards for a qualified mortgage, as set by the Fed. **Sec. 1412 (pp. 783-785)**.

The Fed must prescribe regulations to fulfill this section. The Fed may prescribe regulations that revise the criteria of a qualified loan, upon finding that such regulations are necessary (i) to ensure that affordable mortgage credit remains available to consumers; (ii) to effectuate the purposes of this section; and (iii) to prevent the circumvention of or to facilitate compliance with this section. **Sec. 1412 (p. 785)**.

In consultation with the Fed, the agencies listed must prescribe rules defining the types of loans they guarantee or administer, that are qualified mortgages. These rules may revise the criteria used to define a qualified mortgage upon finding that the rules are consistent with the purpose of the section and to prevent circumvention of or to facilitate compliance with this section. The agencies are: HUD, the Department of Veterans Affairs, the Department of Agriculture, and the Rural Housing Service. **Sec. 1412 (pp.785-786)**.

3. Defense to Foreclosure

When a creditor or other holder of a residential mortgage or anyone acting on their behalf initiates a foreclosure or any other action to collect the debt, a consumer may assert a violation of this section as a matter of defense without regard for the time limit established on a private action for damages. **Sec. 1413 (p. 786)**.

The amount of recoupment or setoff must equal the amount to which the consumer would be entitled for damages for a valid claim brought in an original action against the creditor, plus the costs to the consumer of the action, including reasonable attorneys' fees. If the judgment is rendered after the expiration of the applicable time limit on a private action, the amount of recoupment or setoff must not exceed the amount to which the consumer would have been entitled up to the expiration of the applicable time limit. **Sec. 1413 (p. 786)**.

4. Additional Standards and Requirements

A residential mortgage that is not a "qualified mortgage" may not contain terms under which a consumer must pay a prepayment penalty. A qualified mortgage may not include a residential mortgage that has an adjustable rate or has an annual percentage rate that exceeds the average prime offer rate by specified percentage points according to the circumstances. **Sec. 1414(a) (pp. 786-787)**.

A qualified mortgage may not require a consumer to pay a prepayment penalty that exceeds:

i. 3% of the outstanding loan balance during the first year;

ii. 2% of the outstanding loan balance during the second year; or

iii. 1% of the outstanding loan balance after the third year.

After the end of the 3-year period beginning on the date the loan is consummated, no prepayment penalty may be imposed on a qualified mortgage. **Sec. 1414(a) (pp. 787-788)**.

Additionally, a creditor may not offer a consumer a residential mortgage that has a prepayment penalty without offering the consumer a residential mortgage that does not have a prepayment penalty as a term of the loan. **Sec. 1414(a) (pp. 787-788)**.

No creditor may finance, in connection with any residential mortgage or extension of credit secured by the principal dwelling of the consumer, any life, disability, unemployment, property, accident, loss-of-income, or health insurance, or any payments for debt cancellation or suspension agreement or contract. **Sec. 1414(a) (p. 788)**.

A residential mortgage may not include terms which require arbitration or any other nonjudicial procedure as the method for resolving any controversy or settling any claims arising out of the transaction. This does not limit the right of the consumer and the creditor to agree to arbitration or any other nonjudicial procedure as the method for resolving the controversy at any time after a dispute arises. Also, no provision of any residential mortgage or any extension of credit secured by the consumer's principal dwelling, and no other agreement between the creditor and the consumer relating to either, may be applied or interpreted as barring the consumer from bringing an action in an appropriate district court of the United States or any other court of competent jurisdiction, for damages or other relief in connection with violation of this title. **Sec. 1414(a) (p. 788)**.

A creditor may not extend credit that is secured by a dwelling, other than a reverse mortgage, that provides or permits a payment plan that may, at any time during the extension of the credit, result in negative amortization unless the creditor provides the borrower with a statement disclosing specified information to the borrower and, in the case of a first-time borrower, the borrower provides the creditor with sufficient documentation to demonstrate that the borrower received homeownership counseling. **Sec. 1414(a) (p. 789)**.

If a residential mortgage is subject to protection under an anti-deficiency law — i.e., law of any State which provides that, in the event of foreclosure, the consumer is not liable for any deficiency between the sale price obtained through foreclosure and the outstanding balance of the mortgage —the creditor or mortgage originator must provide written notice to the consumer describing the protection provided by the anti-deficiency law and the significance of its loss. The same is true for refinancing of any residential mortgage that is subject to protection under an anti-deficiency law. **Sec. 1414(c) (pp. 789-790)**.

For a residential mortgage, a creditor must disclose prior to settlement: (i) its policy regarding the acceptance of partial payments; and (ii) if partial payments are accepted, how such payments will be applied to the mortgage and if such payments will be placed in escrow. **Sec. 1414(d) (p. 790)**.

5. Amendments to Civil Liability Provisions

Any action under this section with respect to any violation may be brought in any U.S. district court or in any other court of competent jurisdiction, before the end of the 3-year period beginning on the date the violation occurred. **Sec. 1416 (pp. 790-791)**.

6. Lender Rights in the Context of Borrower Deception

A creditor or assignee <u>must</u> not be liable to an obligor under this section, if the obligor or co-obligor have been convicted of obtaining the residential mortgage loan by actual fraud. **Sec. 1417 (p. 791)**.

7. Six-Month Notice Required Before Reset of Hybrid Adjustable Rate Mortgages

Six months before the date on which the interest rate in effect resets to a variable interest rate or, if the resetting occurs within the first 6 months after consummation, at consummation, the creditor <u>must</u> provide a written notice, separate and distinct from all correspondence to the consumer, indicating the index or formula used in resetting the interest rate, an explanation of how the new interest rate and payment would be determined, a good faith estimate of the new monthly payment after the date of the reset, a list of alternatives the consumer may pursue before the reset, and the name, address, telephone number and internet addresses of counseling agencies and of the state housing finance authority for the state in which the consumer resides. **Sec. 1418 (pp. 791-792)**.

8. Required Disclosures

Required disclosures for a variable rate residential mortgage, for which an escrow account is established for payment of taxes, insurance and assessments, are the amount of the initial monthly payment due for payment of principal and interest, the amount of the monthly payment deposited in the account for the payment of taxes, insurance and assessments, the amount of the fully indexed monthly payment due for the payment of the principal and interest, and the amount of the fully indexed monthly payment deposited in the account for the payment of taxes insurance and assessments. **Sec. 1419 (p. 792)**.

Required disclosures for a residential mortgage are the aggregate amount of settlement charges for all settlement services, the amount of charges that are included in the loan and the amount of such charges the borrower must pay at closing, the approximate amount of the wholesale rate of funds in connection with the loan, and the aggregate amount of other fees in connection with the loan; the aggregate amount of fees paid to the mortgage originator, the amount of such fees paid directly by the consumer and any additional amount received by the originator for the creditor; and the total amount of interest that the consumer will pay over the life of the loan as a percentage of the principal, which is computed assuming the consumer makes equal monthly payments in full and on time and does not make any overpayments. **Sec. 1419 (pp. 792-793)**.

9. Disclosures Required in Monthly Statements for Residential Mortgage Loans

The creditor or servicer to any residential mortgage must transmit to the obligor for each billing cycle, a statement setting forth the following in a conspicuous and prominent manner: the amount of the principal; the current interest rate; the date on which the interest rate may next reset; the amount of any prepayment fee; a description of any late payment fees; the telephone number and email address from which the obligor may obtain information on the mortgage; the names, addresses, telephone numbers and Internet addresses of counseling agencies approved by HUD or a state housing finance authority; and such other information as the Fed may prescribe in regulations. The Fed must develop and prescribe a standard form for the disclosure required under this subsection. This is not applicable to any fixed rate mortgage where the creditor provides the obligor with a coupon book that provides substantially the same information. **Sec. 1420 (p. 793)**.

10. Report by the GAO

The Comptroller must conduct a study to determine the effects this Act will have on the availability of credit for consumers, small businesses, homebuyers, and mortgage lending. Within one year of enactment, the Comptroller General must submit a report to Congress containing the findings and conclusions of the Comptroller as well as an analysis of the effect on the capital reserves and funding of lenders of credit risk retention provisions for non-qualified mortgages.

C. High Cost Mortgages

A "high cost mortgage" is defined as a consumer credit transaction secured by the consumer's principal dwelling, other than a reverse mortgage transaction, if

i. Secured by: (i) a first mortgage on the consumer's primary dwelling and the annual percentage rate (the "APR") at consummation exceeds the average prime offer rate by more than 6.5%; or (ii) a subordinate mortgage on the consumer's principal dwelling and the APR at consummation exceeds the average prime offer rate by more than 8.5%;

ii. The total fees payable, other than *bona fide* third-party charges not retained by the mortgage originator, exceed 5% of the total transaction amount for transactions more than $20,000 or 8% for transactions below $20,000; or

iii. The credit transaction documents permit the creditor to charge prepayment fees or penalties more than 36 months after the transaction closing or such fees or penalties exceed more than 2% of the amount prepaid. **Sec. 1431 (pp. 794-795)**.

No high-cost mortgage may contain a scheduled payment that is more than twice as large as the average of earlier scheduled payments, i.e., a balloon payment. **Sec. 1432 (p. 798)**.

A creditor must not recommend default on an existing loan in connection with the closing of a high-cost mortgage that refinances all or any portion of such existing loan or debt. **Sec. 1433(a) (p. 798)**.

Also, a creditor must not impose a late payment fee on a high-cost mortgage that is in excess of 4% of the payment past due, unless the loan documents specifically authorize the charge, or more than once with respect to a single late payment. A high-cost mortgage may not contain a provision permitting the creditor to accelerate the indebtedness, except when repayment of the loan is accelerated by a default or pursuant to a due-on-sale provision, or pursuant to a material violation of the mortgage agreement unrelated to payment. **Sec. 1433(a) (pp. 798-799)**.

A creditor may not structure a loan transaction as an open-end credit plan or divide the transaction into separate parts so as to evade the provisions of this title. Nor may a creditor charge a consumer a fee to modify, renew or amend a high-cost mortgage. **Sec. 1433(b)-(c) (p. 799)**.

A creditor may not charge a fee for informing any person of the outstanding balance due for payoff of a high-cost mortgage, except processing fees to cover transmission or service if the information is transmitted via fax or courier service. If the creditor has provided this information for free 4 times in a single calendar year, the creditor may charge a reasonable fee for providing the information during the remainder of the calendar year. **Sec. 1433(d) (pp. 799-800)**.

A creditor may not extend credit to a consumer under a high-cost mortgage without first receiving certification from a counselor approved by HUD that the consumer has received counseling on the advisability of the mortgage. The Fed may prescribe regulations, as it deems appropriate, to carry out these requirements. **Sec. 1433(e) (p. 800)**.

A creditor of a high-cost mortgage who, when acting in good faith, fails to comply with any requirement under this section will not be deemed to be in violation of this section if the creditor establishes that either: (i) within 30 days of the loan closing and prior to the institution of any action, the consumer is notified of or discovers the violation, appropriate restitution and proper adjustments are made; or (ii) within 60 days of the creditor's discovery or receipt of notification of an unintentional violation or *bona fide* error and prior to the institution of any action, the consumer is notified of the compliance failure and appropriate restitution and necessary adjustments are made. **Sec. 1433(f) (pp. 800-801)**.

D. Office of Housing Counseling

1. Short Title

This subtitle may be cited as the "Expand and Preserve Home Ownership Through Counseling Act." **Sec. 1441 (p. 801)**.

2. Establishment of Office of Housing Counseling

The Office of Housing Counseling is established in HUD. The head of the Office of Housing Counseling must be the Director of Housing Counseling (the "DHC") who must be appointed by and report to the HUD Secretary. The DHC has primary responsibility within HUD for all activities and matters related to homeownership counseling and rental housing counseling. The DHC establishes rules necessary for counseling procedures, contributing to the distribution of home buying information booklets, carrying out functions regarding abusive lending practices relating to residential mortgages, providing for operation of the advisory committee, collaborating with community-based organizations with expertise in the field of housing counseling and providing for the building capacity to provide housing counseling services in areas that lack sufficient services. **Sec. 1442 (pp. 801-802)**.

The HUD Secretary will appoint an advisory committee to provide advice regarding the carrying out of the functions of the DHC. The advisory committee will not have more than 12 members and the membership must equally represent the mortgage and real estate industries. Each member is appointed for a term of 3 years and will serve without pay, but will receive travel expenses. **Sec. 1442 (pp. 802-803)**.

The DHC must ensure that homeownership counseling addresses the entire process of homeownership, including the decision to purchase a home, the selection and purchase of a home, issues arising during or affecting the period of homeownership and the sale of a home. **Sec. 1442 (p. 803)**.

3. Counseling Procedures

The HUD Secretary must establish and monitor the administration of counseling procedures for homeownership counseling and rental housing counseling. The Secretary in consultation with the advisory committee must establish standards for materials and forms to be used by organizations providing homeownership counseling services. The Secretary must provide for the certification of computer software programs for consumers to use in evaluating different mortgage proposals. If the HUD Secretary determines that the available software is inadequate, the HUD Secretary must arrange for the development of new mortgage software systems that meet the HUD Secretary's specifications. These certified computer software systems must be used to supplement, not replace, housing counseling. **Sec. 1443 (pp. 803-806)**.

The DHC must develop and conduct national public service multimedia campaigns designed to make potentially vulnerable consumers aware that it is advisable to obtain homeownership counseling from an unbiased source before seeking a residential mortgage and that such homeownership counseling is available. Additionally, ten percent of funds allocated to conduct the multimedia campaign must be used by the DHC to conduct an education program in areas that have a high density of foreclosure. **Sec. 1443 (pp. 806-807)**.

4. Grants for Housing Assistance

The HUD Secretary must make financial assistance available to HUD-approved housing counseling agencies and State housing finance agencies. The HUD Secretary must establish standards and guidelines for eligibility of organizations to receive financial assistance. None of the amounts made available may be distributed to an organization that has been convicted for a violation under federal law relating to an election for federal office or an organization that employs someone convicted of such a violation. **Sec. 1444 (p. 808)**.

5. Requirements to Use HUD-Certified Counselors Under HUD Programs

An organization may not receive assistance for counseling activities unless the organization has been certified by the HUD Secretary. Any homeownership counseling or rental housing counseling provided in connection with any program administered by HUD must be provided only by organizations certified by the Secretary as competent to provide such counseling. **Sec. 1445 (p. 809)**.

6. Study of Defaults and Foreclosures

The HUD Secretary must conduct an extensive study of the root causes of default and foreclosure of home loans, using as much empirical data as available. The study must examine the role of escrow accounts in helping borrowers avoid defaults and foreclosures and the role of computer registries of mortgages. Within 12 months of enactment, the Secretary must present a preliminary report to Congress. Within 24 months of enactment, a final report must be presented to Congress and it must include any recommended legislation related to the study and recommendations for a process to identify populations that need counseling the most. **Sec. 1446 (pp. 809-810)**.

7. Default and Foreclosure Database

The HUD Secretary and the DHC, in consultation with the federal agencies responsible for regulation of banking and financial institutions involved in residential mortgages, must establish and maintain a database of information on foreclosures and defaults on mortgages for one- to four-unit residential properties and must make such information publicly available. In establishing and maintaining the database, the HUD Secretary and the DHC must be subject to the standards applicable to federal agencies for the protection of personally identifiable information and for data security and integrity. **Sec. 1447 (p. 810)**.

8. Accountability and Transparency for Grant Recipients

The HUD Secretary must (i) develop and maintain a system to ensure that any organization that receives financial assistance uses all amounts in accordance with this section, any regulations issued under this section, and any conditions under which such amounts were provided; and (ii) require any organization, as a condition of receipt of any financial assistance, to agree to comply with such requirements as the HUD Secretary may establish. If any organization is determined to have used the assistance in a manner in material violation of this section, regulations issued under this section, or conditions under which the assistance was provided, the HUD Secretary must require that within 12 months after the determination of misuse the organization must reimburse the HUD Secretary of the misused amounts and return any unused amounts; and such organization is ineligible to apply for or receive any further financial assistance. **Sec. 1449 (pp. 811-812)**.

9. Updating and Simplification of Mortgage Information Booklet

The Director of the Bureau of Consumer Financial Protection must prepare, at least once every 5 years, a booklet to help consumers applying for federally related mortgages understand the nature and costs of real estate settlement services. The Director of the Bureau must prepare the booklet in various languages and cultural styles, as the Director of the Bureau deems appropriate. The Director of the Bureau must distribute such booklets to all lenders that make federally related mortgages. The Director of the Bureau must prescribe the form and detail of each booklet, which must also include in plain and understandable language:

i. A description and explanation of the nature and purpose of the costs incident to a real estate settlement or a federally related mortgage loan;

ii. An explanation and a sample of the uniform settlement statement required;

iii. A list and explanation of lending practices, including those prohibited by TILA, and of other unfair practices and unreasonable charges to be avoided;

iv. A list and explanation of questions a consumer should ask regarding the mortgage;

v. An explanation of the rights of recession;

vi. A brief explanation of a variable rate mortgage;

vii. A brief explanation of the nature of a home equity line of credit;

viii. Information about homeownership counseling services, a recommendation that the consumer use such services, and notification that a list of certified providers of homeownership counseling and their contact information is available;

ix. An explanation of the nature and purpose of escrow accounts;

x. An explanation of the choices available to buyers of residential real estate in selecting persons to provide necessary services incidental to a real estate settlement;

xi. An explanation of a consumer's responsibilities and obligations in a mortgage transaction;

xii. An explanation of the nature and purpose of real estate appraisals; and

xiii. Notice that HUD has made publicly available a brochure regarding loan fraud and information for obtaining the brochure. **Sec. 1450 (pp. 812-814)**.

10. Home Inspection Counseling

The HUD Secretary must take such actions as necessary to inform potential homebuyers of the availability and importance of obtaining an independent home inspection. The Secretary must make the materials specified available for electronic access and inform potential homebuyers of such availability through home purchase counseling public service announcements and toll-free telephone hotlines. The HUD Secretary must give special emphasis to reaching first-time and low-income homebuyers with these materials and efforts. **Sec. 1451 (p. 814)**.

11. Warnings to Homeowners of Foreclosure Rescue Scams

Ten percent of any amounts made available to HUD during any fiscal year must be used only for assistance to the Neighborhood Reinvestment Corporation for activities to provide notice to borrowers under such loans who are delinquent with respect to payments due under such loans that makes borrowers aware of the dangers of fraudulent activities associated with foreclosure. **Sec. 1452 (p. 815)**.

E. Mortgage Servicing

1. Escrow and Impound Accounts Relating to Certain Consumer Credit Transactions

A creditor, before consummating a credit transaction secured by a first lien on the principal dwelling of the consumer, must establish an escrow account for the payment of taxes, insurance premiums, and any other required periodic payments. **Sec. 1461 (p. 816)**.

An escrow account may not be required as a condition of a property contract or loan secured by a first deed of trust or mortgage on the consumer's principal dwelling unless: (i) the escrow account is required by federal or state law; (ii) a loan is made or guaranteed by a state or federal governmental lending agency; (iii) the transaction is secured by a first lien on the consumer's principal dwelling that has an original principal obligation that either does not exceed the maximum limitation on the original obligation in effect for a residence of applicable size as of the date the interest rate is set and the APR exceeds the average prime offer rate by 1.5% or more; or exceeds the maximum limitation on the original principal obligation in effect for a residence of applicable size as of the date the interest rate is set and the APR exceeds the average prime offer rate by 2.5% or more; or (iv) so required pursuant to regulation. **Sec. 1461 (p. 816)**.

An escrow account will remain in existence for a minimum period of 5 years, unless and until the borrower has sufficient equity in the dwelling as to no longer be required to maintain private mortgage insurance, the borrower is delinquent, the borrower has not complied with the legal obligation, or the underlying mortgage is terminated. The escrow account must be administered by a federally insured depository institution or credit union. **Sec. 1461 (p. 817)**.

For an escrow account, a creditor must disclose in writing 3 business days before the consummation of the credit transaction that an escrow account will be established, the amount required at closing to initially fund the escrow account, the amount of the estimated taxes, insurance premiums and other required periodic payments in the initial year, the estimated monthly amount payable to be escrowed, that if the consumer terminates the account, the consumer will be responsible for payment of all taxes, insurance premiums and other required periodic payments, unless a new escrow account is established, and such other information as the Fed determines is necessary. **Sec. 1461 (p. 818)**.

The Fed may prescribe rules that revise the criteria regarding the requirements of escrow accounts if the Fed determines that such rules are in the interest of consumers and in the public interest. **Sec. 1461 (p. 819)**.

2. Disclosure Notice Required for Consumers Who Waive Escrow Services

If an escrow account for the payment of all taxes, insurance premiums and other required periodic payments is not established or a consumer chooses and provides written notice to the creditor of the choice at any time after the account is established, to close the account, the creditor must provide timely and clearly written disclosure that advises the consumer of the responsibilities of the consumer and the implication in the absence of the account. **Sec. 1462 (p. 819)**.

The disclosure provided to the consumer must include: (i) information concerning all applicable fees associated with the non-establishment of the account at the time of the transaction or subsequently; (ii) a clear and prominent statement that the consumer is responsible for paying the non-escrowed items and that the costs can be substantial; (iii) a clear explanation of the consequence of failure to pay non-escrowed items; and (iv) such other information as the Fed determines necessary. **Sec. 1462 (p. 819-820)**.

3. Real Estate Settlement Procedures Act of 1974 Amendments

A servicer must not: obtain force-placed hazard insurance unless there is a reasonable basis to believe the borrower has failed to maintain property insurance; charge fees for responding to valid qualified written requests; fail to take timely action to respond to a borrower's requests to correct errors relating to the allocation of payments, final balances for paying off the mortgage, avoiding foreclosure or other standard servicer duties; fail to respond in 10 business days to a borrower request for the identity, address, and other relevant contact information of the owner of the loan; or fail to comply with any other obligation established by the Bureau through regulations. **Sec. 1463 (p. 820)**.

A servicer does not have a reasonable basis for obtaining force-placed insurance and may not charge a borrower for force-placed insurance unless:

- The servicer has sent a written notice including: a reminder of the borrower's obligation to maintain hazard insurance, a statement that the servicer does not have any evidence of insurance coverage, a clear and conspicuous statement of the ways the borrower may demonstrate existing insurance coverage, and a statement that the servicer may obtain such insurance at the borrower's expense if the borrower does not demonstrate existing coverage in a timely manner;

- The servicer has sent a second written notice with the information described above, at least 30 days after the mailing of the first notice;

- The servicer has not received from the borrower any demonstration of hazard insurance coverage within 15 days of the second notice. **Sec. 1463 (pp. 820-821).**

4. TILA Amendments

With regard to a credit transaction secured by a consumer's principal dwelling, a creditor must not fail to credit a payment to the consumer's loan account as of the date of receipt, unless the delay does not result in any charge to the consumer or reporting of negative information to a consumer reporting agency. A creditor must send an accurate payoff balance within a reasonable time, but in no case more than 7 business days, after receipt of a written request for such a balance. **Sec. 1464 (p. 822)**.

5. Escrows Included in Repayment Analysis

With regard to any consumer credit transaction secured by a first mortgage on the principal dwelling of the consumer, for which an escrow account has been or will be established for the payments of all taxes, insurance premiums and other required periodic payments, the information with regard to number, amount, and due dates or period of payments scheduled to repay the total of payments must take into account the amount of any monthly payment to such account for each such repayment. The amount taken into account for the payment of all taxes, insurance premiums and other required periodic payments are required to reflect the taxable assessed value of the property securing the transaction after consummation. **Sec. 1465 (pp. 822-823)**.

F. Appraisal Activities

1. Property Appraisal Requirements

A creditor may not extend a higher-risk mortgage to any consumer without first obtaining a written appraisal of the property to be mortgaged. An appraisal of the property that secures a higher-risk mortgage must be performed by a certified appraiser who conducts a physical property visit of the interior of the mortgaged property. If the purpose of the higher-risk mortgage is to finance the purchase of the mortgaged property from a person within 180 days of the purchase of such property at a price that is lower than the current sale price, the creditor must obtain a second appraisal from a different certified or licensed appraiser. The second appraisal must include an analysis of the difference in sale prices, changes in market conditions, and any improvements made to the property between the previous sale and the current sale. The Fed, the

Comptroller, the FDIC, the NCUAB, and the Bureau must jointly prescribe regulations to implement this section. **Sec. 1471 (pp. 823-824)**.

A creditor must provide one copy of each appraisal conducted in connection with this section to the applicant without charge, at least 3 days before the transaction closing date. At the time of the initial mortgage application, the applicant is required to be provided with a statement by the creditor that any appraisal prepared for the mortgage is for the sole use of the creditor and that the applicant may choose to have a separate appraisal conducted at the expense of the applicant. A creditor who willfully failed to obtain an appraisal as required by this section is liable to the applicant for $2,000. **Sec. 1471 (p. 824)**.

2. Appraisal Independence Requirements

Dodd-Frank makes it unlawful, in extending credit secured by the principal dwelling of the consumer, to engage in any act or practice that violates appraisal independence. No certified appraiser conducting an appraisal in connection with an extension of credit secured by the principal dwelling of a consumer may have any interest in the property or transaction involving the appraisal. **Sec. 1472 (pp. 825-826)**.

Any mortgage lender, broker, banker or other person involved in a real estate transaction involving an appraisal who has a reasonable basis to believe an appraiser is failing to comply with the *Uniform Standards of Professional Appraisal Practice* must refer the matter to the applicable State appraiser certifying and licensing agency. A creditor who knows, at or before consummation, of a violation of the appraisal independence standards must not extend credit based on such appraisal unless the creditor documents that the creditor has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of such dwelling. The Fed must prescribe interim regulations no later than 90 days after the enactment of this section defining with specificity acts that violate appraisal independence. On the date the interim final regulations are issued, the Home Valuation Code of Conduct announced by the Federal Housing Finance Agency on December 23, 2008 has no force or effect. **Sec. 1472 (pp. 826-827)**.

3. Amendments Related to Appraisal Subcommittee of the Federal Financial Institutions Examinations Council, Appraiser Independence Monitoring, Approved Appraiser Education, Appraisal Management Companies, Appraiser Complaint Hotline, Automated Valuation Models and Broker Price Opinions

a. Appraisal Management Company Minimum Requirements

The Fed, the Comptroller of the Currency, the FDIC, the NCUAB, the Federal Housing Finance Agency, and the Bureau must jointly establish minimum requirements to be applied by a state in the registration of appraisal management companies, which must include a requirement that such companies: (i) register and be subject to supervision by a state appraiser certifying and licensing agency in each State in which the company operates; (ii) verify that only licensed and certified appraisers are used for federally related transactions; (iii) require that appraisals comply with the Uniform Standards of Professional Appraisal Practice; and (iv) require that appraisals are conducted independently. **Sec. 1473(f) (pp. 829-830)**.

An appraisal management company will not be allowed to be registered by a State or included in the national registry if such company is owned by any person who has had an appraiser license refused, surrendered or revoked in any State. Also, each person that owns more than 10% of an appraisal management company must be of good moral character, as determined by the state appraiser certifying and licensing agency, and must submit to a background investigation. **Sec. 1473(f) (p. 830)**.

No appraisal management company may perform services related to a federally related transaction 36 months after the regulations required under this subsection are prescribed in final form, unless such company is registered with such State or subject to oversight by a federal financial institutions regulatory agency. **Sec. 1473(f) (p. 831)**.

b. The Appraisal Subcommittee

The Appraisal Subcommittee monitors each state appraiser certifying and licensing agency for the purposes of determining whether such agency has policies and procedures that are consistent with this title, processes complaints and completes investigations in a reasonable time period, appropriately disciplines sanctioned appraisers, maintains an effective regulatory program, and reports complaints and disciplinary actions on a timely basis to the national registries on appraisers. **Sec. 1473(k) (p. 834)**.

The Appraisal Subcommittee has the authority to remove a state licensed appraiser from a national registry on an interim basis not to exceed 90 days, pending state agency action. The Appraisal Subcommittee and all agencies and federally recognized entities will not be permitted to recognize appraiser certifications from States whose appraisal policies and procedures are inconsistent with this title. The Appraisal Subcommittee has the authority to impose sanctions against a state agency that fails to have an effective appraiser regulatory program. The Appraisal Subcommittee has the authority to impose interim actions and suspensions against a State agency as an alternative to or in advance of the de-recognition of a state agency. **Sec. 1473(k) (p. 834)**.

The Appraisal Subcommittee monitors each state appraiser certifying and licensing agency for purposes of determining whether such agency's policies and procedures are consistent with the purposes of maintaining appraiser independence. **Sec. 1473(n) (p. 835)**.

c. Automated Valuation Models

Automated valuation models must adhere to quality control standards designed to ensure a high level of confidence in the estimates produced, protect against manipulation of data, seek to avoid conflicts of interest, require random sample testing and reviews, and account for any other factors that the agencies deem appropriate. **Sec. 1473(q) (p. 836)**.

d. Broker Price Opinions

With regard to the purchase of a consumer's principal dwelling, broker price opinions—i.e., an estimate prepared by a real estate broker that details the probable selling price of a particular piece of property—may not be used as the primary basis to determine the value of a piece of property for the purpose of a loan origination of a residential mortgage secured by such property. **Sec. 1473(r) (pp. 836-837)**.

e. Equal Credit Opportunity Act Amendment

A creditor must furnish to an applicant a copy of all appraisals developed in connection with the application for a loan secured by a first lien on a dwelling no later than 3 days prior to the closing of the loan. The applicant may waive the 3 day requirement except where otherwise required by law. The applicant may be required to pay a reasonable fee to reimburse the creditor for the cost of the appraisal except where otherwise required by law. Notwithstanding the foregoing, the creditor must provide a copy of each written appraisal at no additional cost to the applicant. **Sec. 1474 (pp. 837-838)**.

f. GAO Study

The GAO is required to conduct a study on the effectiveness and impact of appraisal methods, appraisal valuation models, appraisal distribution channels, the Home Valuation Code of Conduct and the Appraisal Subcommittee's functions. Within 12 months of the enactment of this Act, the GAO must submit a study to the Senate Banking Committee and the House Financial Services Committee. Within 90 days of the enactment of the Act, the GAO must provide a status report on the study and any preliminary findings to the aforementioned Committees. **Sec. 1476 (pp. 838-839)**.

No later than 18 months after the enactment of this Act, the GAO must submit a study to the Senate Banking Committee and the House Financial Services Committee, which will be required to include an examination of the Appraisal Committee's ability to monitor and enforce state and federal certification requirements, whether existing federal financial institutions regulatory agency exemptions on appraisals need to be revised, whether new means of data collection would benefit the Appraisal Subcommittee's ability to perform its function and recommendations from this examination for administrative and legislative action at the federal and state levels. **Sec. 1476 (pp. 839-840)**.

G. Mortgage Resolution and Modification

1. Multifamily Mortgage Resolution Program

The HUD Secretary must develop a program to ensure the protection of current and future tenants and at-risk multifamily properties based on criteria that may include: creating sustainable financing of such properties; maintaining the level of federal, state and city subsidies in effect as of the date of the enactment of this Act; providing funds for rehabilitation; and facilitating the transfer of such properties to responsible new owners and ensuring affordability of such properties. **Sec. 1481(a) (p. 840)**.

No person will be eligible to begin receiving assistance from the Making Home Affordable program or any other mortgage assistance program authorized by the Emergency Economic Stabilization Act of 2008, if such person in connection with a mortgage or real estate transaction has been convicted within the last ten years of felony larceny, theft, fraud, forgery, money laundering or tax evasion. **Sec. 1481(d) (pp. 840-841)**.

The HUD Secretary must establish procedures to ensure compliance with this subsection. The HUD Secretary must report to the Senate Banking Committee and House Financial Services Committee regarding the implementation of this provision. The report must also describe steps taken to implement this subsection. **Sec. 1481(d) (p. 841)**.

2. Making Home Affordable Modification Program Guidelines

The Secretary is required to revise the guidelines for the Making Home Affordable Modification Program to require each mortgage servicer participating in the program to provide each borrower under a mortgage whose request for modification is denied with all borrower-related and mortgage-related input data used in any net present value ("NPV") analyses performed in connection with the mortgage. **Sec. 1482(a) (p. 841)**.

With regard to the Making Home Affordable Modification Program, the Secretary must establish and maintain a website that provides a calculator for NPV analyses for a mortgage, that mortgagors can use to enter information regarding their own mortgage and that provides a determination regarding whether such mortgage would be accepted or rejected for modification under the Program. **Sec. 1482(a) (p. 841)**.

3. Public Availability of Information

The Secretary must revise the guidelines for the Making Home Affordable Modification Program to provide that the data being collected from each mortgage servicer participating in the Program is made publicly available. Within 14 days of each monthly deadline for submission of data by mortgage servicers participating in the Program, reports must be made publicly available that include the number of requests for mortgage modification received, processed, accepted and denied. Within 60 days after each monthly deadline for submission of data, the Secretary must make data tables available to the public. **Sec. 1483 (p. 842)**.

H. Miscellaneous Provisions

1. Sense of Congress Regarding the Importance of Government-Sponsored Enterprises Reform to Enhance the Protection, Limitation and Regulation of the Terms of Residential Mortgage Credit

The Dodd-Frank Act states that Congress finds the following:

i. Fannie Mae and Freddie Mac were chartered by Congress to ensure a reliable and affordable supply of mortgage funding;

ii. In 1996, HUD required that 42% of Fannie Mae's and Freddie Mac's mortgage financing should go to borrowers with income levels below the median for a given area;

iii. In 2004, the goal was revised, increasing them to 56% of their overall mortgage purchases by 2008;

iv. To help fulfill those mandated affordable housing goals, in 1995

HUD authorized Fannie Mae and Freddie Mac to purchase subprime securities that included loans made to low-income borrowers;

v. In 2004 alone, Fannie Mae and Freddie Mac purchased $175 billion in subprime mortgage securities and from 2005 through 2007 Fannie Mae and Freddie Mac purchased approximately $1 trillion in subprime loans;

vi. On September 7, 2008, the FHFA placed Fannie Mae and Freddie Mac into conservatorship with the Treasury Department agreeing to purchase at least $200 billion of preferred stock from each enterprise in exchange for warrants for the purchase of 79.9% of each enterprise's common stock;

vii. The conservatorship of Fannie Mae and Freddie Mac has potentially exposed taxpayers to upwards of $5.3 trillion worth of risk; and

viii. The hybrid public-private status of Fannie Mae and Freddie Mac is untenable and must be resolved to assure that consumers are offered and receive residential mortgages on terms that reasonably reflect their ability to repay the loans.

The Act also states that is the sense of Congress that efforts to enhance by the protection, limitation and regulation of the terms of residential mortgage credit and the practices related to such credit would be incomplete without meaningful structural reforms of Fannie Mae and Freddie Mac. **Sec. 1491 (pp. 843-844)**.

2. GAO Study Report

The Comptroller General must conduct a study of the current inter-agency efforts of the Secretary, the HUD Secretary, the Attorney General, and the FTC to crack down on mortgage foreclosure rescue scams and loan modification fraud. **Sec. 1492(a) (p. 844)**.

The Comptroller General must submit a report to the Congress on the study conducted containing such recommendations for legislative and administrative actions as the Comptroller deems appropriate. The report is required to include: (i) an evaluation of the effectiveness of the inter-agency task force current efforts to combat mortgage foreclosure rescue scams and loan modification fraud scams; (ii) specific recommendations on agency or legislative action that are essential to properly protect homeowners from mortgage foreclosure rescue scams and loan modification fraud scams; and (iii) the adequacy of financial resources that the federal government is allocating to crack down on loan modification and foreclosure rescue scams and the education of homeowners about fraudulent scams relating to loan modification and foreclosure rescues. **Sec. 1492 (p. 844)**.

3. Study of Effect of Drywall Presence on Foreclosures

The HUD Secretary in consultation with the Secretary must conduct a study of the effect on residential mortgage loan foreclosures of the presence of drywall imported from China in residential structures and the availability of property insurance for residential structures in which such drywall is present. This report must be presented to Congress no later than 120 days after the enactment of this Act. **Sec. 1494 (p. 845)**.

4. Emergency Mortgage Relief

As of October 1, 2010, $1 billion is made available to the HUD Secretary to provide assistance through the Emergency Homeowners' Relief Fund, which is established for emergency mortgage assistance. **Sec. 1496 (p. 845)**.

The HUD Secretary must establish underwriting guidelines to allocate amounts available for loans under this section and for emergency relief payments based on the likelihood that a mortgagor will be able to resume mortgage payments. **Sec. 1496 (p. 846)**.

5. Additional Assistance for Neighborhood Stabilization Program

As of October 1, 2010, $1 billion is available to the HUD Secretary to be used for assistance to States and local government units for the redevelopment of abandoned and foreclosed homes. None of the amounts made available may be distributed to any organization that has been convicted for a violation under federal law relating to election for a federal office or any organization that employs someone who has been convicted of the same. **Sec. 1497 (pp. 847-848)**.

6. Legal Assistance for Foreclosure-Related Issues

The HUD Secretary must establish a program for making grants for providing a full range of foreclosure legal assistance to low- and moderate-income homeowners and tenants related to home ownership preservation, home foreclosure prevention, and tenancy associated with home foreclosure. **Sec. 1498(a) (p. 849)**.

Any state or local legal organization that receives financial assistance pursuant to this section may use such amounts only to assist homeowners of owner-occupied homes with mortgages in default, in danger of default, or subject to or at risk of foreclosure; and tenants at risk of or subject to eviction as a result of foreclosure of the property in which such tenant resides. Any state or local legal organization that receives financial assistance must begin using any financial assistance received within 90 days after receipt of the assistance. This subsection takes effect on the date of enactment of this Act. None of the amounts made available may be distributed to any organization that has been convicted for a violation under federal law relating to election for a federal office or any organization that employs someone who has been convicted of the same. **Sec. 1498 (d)-(e) (pp. 849-850)**.

TITLE XV: Miscellaneous Provisions

A. Restrictions on the use of U.S. Funds for Foreign Governments; Protection of American Taxpayers

This title amends the *Bretton Woods Agreements Act* by restricting the use of U.S. funds for foreign governments. **Sec. 1501 (p. 850)**. The Act requires the U.S. Executive Director at the International Monetary Fund (the "IMF") to evaluate proposed loans by the IMF to a country if that country's public debt exceeds its gross domestic product, and the country is not eligible for development assistance from the International Development Association. **Sec. 1501(a)(1) (p. 850)**. If the evaluation suggests that the loans will not be paid back in full, the Executive Director must oppose the proposal. **Sec. 1501(a)(2) (p. 850)**. Within 30 days of approving a proposal, and after that, annually by June 30 for the duration of the program, the Secretary must report to the House Financial Services Committee, the Senate Banking Committee, and the Senate Foreign Relations Committee detailing the likelihood that loans made will be paid in full. The report should include the borrowing country's debt status, the borrowing country's external and internal vulnerabilities, and the borrowing country's debt management strategy. **Sec. 1501(b) (pp. 850-851)**.

B. Conflict Minerals

The Act condemns the exploitation and trade of conflict minerals in the Democratic Republic of Congo (the "DRC"). This section requires the SEC to adopt new rules no later than April 17, 2011 (270 days after enactment) relating to manufacturers that use minerals originating from the DRC and require them to disclose measures taken to exercise due diligence on the source of minerals and the chain of custody of materials used. **Sec. 1502 (pp. 851-852)**. Mineral manufacturers must submit a report to the SEC that includes a description of due diligence used on the source and chain of custody of such minerals, and a description of the products manufactured that are not DRC conflict free. **Sec. 1502(b)(1) (p. 851)**. The report must be certified by someone deemed reliable by the SEC. **Sec. 1502(b)(1)(C) (p. 852)**. This information must be made available to the public. **Sec. 1502(b)(1)(E) (p. 851)**. The Act further requires the Secretary of State, in consultation with the Administrator of USAID, to submit a strategy to address the human rights abuses and trade of conflict minerals to appropriate congressional committees. **Sec. 1502(c) (p. 853)**. The strategy must include a plan to promote peace and security in the DRC, a plan to provide guidance to commercial entities seeking to avoid trading conflict minerals, and a description of punitive measures that might be taken against offending entities. **Sec. 1502(c)(1)(B) (p. 853)**.

No more than 180 days after the enactment of this Act, the Secretary of State <u>must</u> produce a "Conflict Minerals Map" of mineral rich zones, trade routs and areas under control by armed groups in the DRC and adjoining countries. **Sec. 1502(c)(2) (pp. 853-854)**. In no more than one year after this Act is enacted, and annually after that, the Comptroller General must submit a report to appropriate congressional committees that assesses the rate of gender-based and sexual-based violence in the DRC. **Sec. 1502(d)(1) (p. 854)**. No more than two years after the enactment of this Act, the Comptroller General must submit a report to appropriate committees in congress that includes an assessment of the effectiveness of this Act in promoting peace and security in the DRC, issues encountered by the SEC in carrying out this section of the Act, and a general review of the use of conflict minerals. **Sec. 1502(d)(2) (pp. 854-855)**. Not more than 30 months after the enactment of this Act, the Secretary of Commerce must submit to appropriate congressional committees a report that includes an assessment of the accuracy of private sector audits and other due diligence processes, recommendations for the processes used to carry out such audits, and a listing of all known conflict mineral processing facilities worldwide. **Sec. 1502(d)(3) (p. 855)**.

C. Reporting Requirements Regarding Coal or Other Mine Safety

The Act requires each public company that operates, or has a subsidiary that operates, a coal or other mine to disclose mine safety information in each periodic report filed with the SEC under securities laws, beginning on or after enactment. **Sec. 1503(a) (p. 856)**. The report must include total violations of health or safety standards, the total number of citations and orders for unwarrantable failure of mine operators to comply with mandatory health or safety standards, the number of flagrant violations of standards, the number of imminent danger orders issued, the dollar value of proposed assessments from the Mine Safety and Health Administration, and the total number of mining-related fatalities. **Sec. 1503(a)(1) (pp. 856-857)**. The report must also include a list of coal or other mines that have received notice from the Mine Safety and Health Administration of a pattern or potential pattern of safety standard violations, and any pending legal action before the Federal Mine Safety and Health Review Commission involving a mine. **Sec. 1503(a)(2)-(3) (p. 857)**. Beginning on the date of enactment, each coal or other mine operator must file a Current Report on Form 8-K with the SEC disclosing the receipt of any imminent danger order issued under the FMSHA and any written notice from the Mine Safety and Health Administration of a pattern or potential pattern of health or safety standard violations. **Sec. 1503(b) (p. 857)**. A violation under this section will be treated as a violation of the Exchange Act and subject to the same penalties. **Sec. 1503(d) (p. 857)**. This section takes effect August 20, 2011 (30 days after the enactment of the Act). **Sec. 1503(f) (p. 858)**.

D. Disclosure of Payments by Resource Extraction Issuers

This section amends Title 13 of the Exchange Act to require the SEC to issue final rules to require each resource extraction issuer to include a final report of all payments made from the resource extraction issuer or subsidiary to a foreign government or the U.S. federal government for the purpose of commercial development of oil, natural gas, or minerals. **Sec. 1504(q)(2) (pp. 858-859)**. In issuing rules, the SEC may consult with any agency or entity it deems relevant. **Sec. 1504(q)(2)(B) (p. 859)**. The rules must be issued in an interactive data format, and support the commitment of the federal government to international transparency efforts relating to the development of oil, gas, and minerals. **Sec. 1504(q)(2)(D) (p. 859)**. To that end, the information issued must be made public. **Sec. 1504(q)(3)(A) (p. 860)**. The SEC must adopt rules no later than April 17, 2011 (270 days after enactment), which rules will apply to annual reports for fiscal years ending after the first anniversary of the rules' adoption. **Sec. 1504(q)(2)(F) (p. 860)**.

E. Study by the Comptroller General

No more than one year after the enactment of this Act, the Comptroller General must issue a report assessing the independence, effectiveness, and expertise of presidentially appointed inspectors general and inspectors general of designated federal entities. **Sec. 1505(a) (p. 860)**. The report must be issued to specified congressional committees. **Sec. 1505(b) (p. 860)**.

F. Study on Core Deposits and Brokers Deposits

The Act requires the FDIC to conduct a study of the differences between core deposits and brokered deposits and their role on the economy and the banking sector, the potential impact on the Deposit Insurance Fund of revising the definitions to better distinguish between brokered deposits and core deposits, the potential stimulative effect on local economies by redefining core deposits, and the competitive parity between large institutions and community banks that could result from redefining core deposits. **Sec. 1506(a) (p. 860)**. The FDIC must submit a report on the results of the study, including recommendations, to Congress, no later than one year after the enactment of this Act. **Sec. 1506(b) (pp. 860-861)**.

TITLE XVI: Section 1256 Contracts

Title XVI amends Section 1256 of the Internal Revenue Code. Section 1256 provides that certain contracts, including regulated futures contracts, foreign currency contracts, nonequity options, dealer equity options, and dealer securities futures contracts, must be treated as if they are sold at fair market value on the last business day of the tax year for tax purposes.

Title XVI excludes certain categories of contracts from the term "Section 1256 contract" including: securities futures contracts and options on those contracts, except dealer securities future contracts, and any interest rate swap, currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, CDS, or similar agreements. **Sec. 1601(a) (p. 861)**.

The title becomes effective for the taxable years beginning after the date of enactment. **Sec. 1601(b) (p. 861)**.

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Appendix A

Comparison of Title II of the Dodd-Frank Act, Bankruptcy Code, and Federal Deposit Insurance Act

Comparison of Title II of the Dodd-Frank Act, Bankruptcy Code
and Federal Deposit Insurance Act

The following chart compares the Act to the Bankruptcy Code and the FDIA, including (i) the financial companies covered, (ii) the grounds for exercising resolution powers, (iii) the resolution powers available to the FDIC, (iv) special provisions concerning qualified financial contracts, and (v) the Regulatory Agency's authority to handle claims from creditors, with limited judicial oversight.

Supervisory entity ("Regulatory Agency")	The Bankruptcy Courts, subject to the appellate jurisdiction of the federal district courts, circuit courts and the Supreme Court. 11 U.S.C. § 105. The Office of the United States Trustee, a division of the Department of Justice (the "UST"), is charged with oversight of the administrative issues in bankruptcy. A local representative of the UST is typically assigned to monitor every chapter 11 case. The UST is concerned with protecting creditors' rights, and typically appoints an official committee of unsecured creditors, consisting of creditors holding the largest claims against the debtor.	The FDIC is the Regulatory Agency for covered financial companies ("CFCs"). CFCs are defined as financial companies, other than insured depository institutions, for which a determination has been made by the Secretary of the Treasury (the "Secretary") under § 203(b). § 201(a)(8). When the CFC is a broker or dealer registered with the Securities and Exchange Commission (the "SEC") and a member of the Securities Investor Protection Corporation ("covered broker or dealer" or "CBD"), the Securities Investor Protection Corporation ("SIPC") will be appointed as the trustee to liquidate the CBD. §§ 201(a)(7) and 205(a). The Act grants the United States District Court of the District of Columbia (the "Court") original and exclusive jurisdiction over petitions by the Secretary for an order to appoint the FDIC as receiver of a CFC if the board of directors of such CFC does not consent or acquiesce to the FDIC's appointment. § 202(a).	The FDIC. The FDIC has broad powers over the process prescribed in the FDIA. There is minimal court supervision and judicial review.

Laws governing the proceedings	Title 11 of the United States Code (the "Bankruptcy Code"), the Federal Rules of Bankruptcy Procedure ("FRBP"), and Local Rules for each jurisdiction.	The Act, with rules and regulations passed by the FDIC. The Act applies exclusively to all CFCs for which the FDIC has been appointed as the receiver. § 202(c)(2). The Bankruptcy Code applies to all financial companies that are not CFCs for whom the FDIC has been appointed as the receiver. § 202(c)(1).	The Federal Deposit Insurance Act, with limited regulations passed by the FDIC.
Judicial precedent	Significant judicial precedent.	No judicial precedent exists for the Act. The FDIC must seek to harmonize the provisions of the Act with insolvency laws that would otherwise apply to a CFC and address the potential for conflicts of interest between or among individual receiverships established under this title or under the Federal Deposit Insurance Act. § 209.	Some judicial precedent.
Who is covered	The Bankruptcy Code applies to individuals or other "persons" who reside, are domiciled or have a place of business or property in the United States, with the exception generally of banks and savings and loan associations, railroads and insurance companies. Municipalities (chapter 9) and entities with pending foreign bankruptcy proceedings (chapter 15) may also seek relief under the Bankruptcy Code. 11 U.S.C. § 109. Insurance companies are governed by state insurance insolvency codes. Broker-dealers that are members of the Securities Investor Protection Corporation ("SIPC") are subject to the Securities Investor Protection Act ("SIPA"), but may also file chapter 7 liquidation cases under the Bankruptcy Code. Although generally the Bankruptcy Code would continue to apply to most financial companies, the Act would make the Bankruptcy Code unavailable to a financial company if the Treasury elected to put such financial company into an FDIC	The Act applies to any financial company, which (i) is a company incorporated or organized under federal law or the laws of any State, (ii) is: • a bank holding company; • a nonbank financial company supervised by the Federal Reserve Board (the "Fed") pursuant to the provisions of Title I under the Act; • any company that is predominantly engaged in activities that the Fed has determined are financial in nature or incidental thereto for purposes of section 4(k) of the Bank Holding Company Act of 1956; or • any subsidiary of the above that is predominantly engaged in activities that the Fed has determined are financial in nature or incidental thereto for purposes of section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. § 1843(k)) (other than a subsidiary that is an insured depository institution or insurance company); and	The FDIA governs FDIC-insured bank or thrift subsidiaries. The Act would not affect the entities that are subject to an FDIC proceeding.

	receivership. The appointment of the FDIC as receiver for the CFC would automatically terminate any bankruptcy case in progress. § 208(a).	(iii) is not a Farm Credit System institution chartered under and subject to the provisions of the Farm Credit Act of 1971, as amended (12 U.S.C. § 2001 et seq.), government entity or regulated entity (as defined under section 1303 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. § 4502(20)). § 201(a)(11). For a company to classify as a financial company due to activities that the Fed has determined are financial in nature for purposes of section 4(k) of the Bank Holding Company Act, 85 percent or more of the company's revenue must come from such activities. § 201(b). "Covered subsidiaries" are subsidiaries of a CFC that are not insured depository institutions, insurance companies or CBDs. § 201(a)(9). The FDIC may appoint itself as receiver of a covered subsidiary if the FDIC and the Secretary jointly determine that (i) the covered subsidiary is in default or danger of default; (ii) such action would avoid serious adverse effects on the U.S. economy; and (iii) such action would facilitate the orderly liquidation of the CFC. § 210(a)(1)(E). CFCs, or subsidiaries of CFCs, that are insurance companies are resolved under State law, but if the proper regulatory agency has not taken action under State law within 60 days of a determination that such company is a CFC, then the FDIC may stand in place of the proper regulatory agency and take appropriate action under State law. § 203(e).	
Commencement of proceedings	An eligible entity may elect to file a voluntary bankruptcy petition. 11 U.S.C. § 301. Although solvent companies can be debtors, the Bankruptcy Court may dismiss the case based on bad faith filing. Three or more entities, each of which holds an unsecured, non-contingent, undisputed claim, which aggregate to at least $13,475, can file an involuntary petition, which may be contested by the debtor/company. Any disputes will be evaluated by the Bankruptcy	On their own initiative, or at the request of the Secretary, the Fed and the FDIC, or the Fed and the SEC (in the case of a CBD) or Federal Insurance Office (in the case the CFC or its largest U.S. subsidiary is an insurance company) each with a 2/3 vote of approval, issue a joint written recommendation to the Secretary. § 203(a). The written recommendation must contain an evaluation of whether the financial company is in default or in danger of default; a description of the effect the default of the financial company would	A conservator or receiver may be appointed without a systemic risk determination if the grounds specified in the FDIA apply. 12 U.S.C. § 1821(c)(5). Generally, the FDIC is required to meet a statutory "least cost resolution" standard when determining how to resolve a failed bank, which includes estimating the costs of liquidation. However, the FDIC has broader powers if there is a systemic risk determination that (a) the FDIC's compliance with the "least cost

	Court which will make a finding as to whether the company is paying its debts as they come due. If there are fewer than 12 such creditors, a single creditor holding at least $13,475 in unsecured, non-contingent, undisputed claims, may file the involuntary petition. 11 U.S.C. § 303.	have on financial stability in the U.S.; a description of the effect the default would have on economic conditions or financial stability of low income, minority or underserved communities; a recommendation regarding the nature and the extent of actions to be taken; an evaluation of the likelihood of a private sector alternative preventing the default of the financial company or rendering the financial company solvent; an evaluation of why a case under the Bankruptcy Code is not appropriate; an evaluation of the effect on creditors, counterparties and shareholders of the financial company and other market participants; and an evaluation of whether the company satisfies the definition of a financial company under § 201. § 203(a)(2). The Secretary (in consultation with the President) must determine, based on the written recommendation, that (i) the financial company is in default or in danger of default, (ii) the failure of the financial company and its resolution under otherwise applicable Federal or State law would have serious negative effects on U.S. financial stability, (iii) private sector alternatives will not prevent the default of the CFC, (iv) any effect on the claims and interests of creditors, counterparties and shareholders of the financial company and other market participants is appropriate given the impact of such actions on the U.S. economy, (v) actions under the Act would avoid or mitigate such adverse effects, (vi) a federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments and (vii) the company satisfies the definition of a financial company under section 201. § 203(b). Upon such determination by the Secretary, the financial company becomes a CFC. § 201(a)(8). A company is in "default or in danger of default" if (i) a case has been, or likely will be, commenced with respect to the financial company under the Bankruptcy Code; (ii) the financial company has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital and there is no reasonable prospect for the company to avoid such depletion; (iii) the assets of the financial company	resolution" requirements for government assistance with respect to an institution would have serious adverse effects on economic conditions or financial stability and (b) any assistance under 12 U.S.C. § 1823 would avoid or mitigate such adverse effects. 12 U.S.C. § 1823(c)(4)(G). In the event of this determination, the FDIC may then take action or provide assistance under § 1823 as necessary to avoid/mitigate such effects. This determination requires the recommendation of the FDIC and the Fed, and approval of the Secretary, in consultation with the President.

		are, or are likely to be, less than its obligations to creditors and others; (iv) the financial company is, or is likely to be, unable to pay its obligations in the normal course of business; or (v) the financial company consents to the appointment of the FDIC as receiver. § 203(c)(4). Subsequent to a determination by the Secretary under section 203 that a financial company satisfies the criteria in section 203(b), the Secretary must notify the board of directors of the CFC of its determination. If the board of directors does not consent to the appointment, the Secretary must petition the Court for an order authorizing the Secretary to appoint the FDIC as receiver. § 202(a)(1)(A)(i). The Court, after a hearing in which the CFC may oppose the petition, must determine whether the finding of the Secretary that the CFC is in default or in danger of default and satisfies the definition of a "financial company" under section 201(a)(11) is arbitrary and capricious. § 202(a)(1)(A)(iii). If the Court finds the Secretary's determination is not arbitrary and capricious, the Court must issue an order immediately authorizing the Secretary to appoint the FDIC as receiver for the CFC. If the Court finds the Secretary's determination is arbitrary and capricious, the Court must immediately provide the Secretary with a written statement of the reasons for its determination, and afford the Secretary an immediate opportunity to amend and refile the petition. § 202(a)(1)(A)(iv). If the Court does not make a determination within 24 hours of receipt of the petition, the petition must be granted by operation of law, the FDIC must be appointed receiver of the CFC and liquidation under this title must commence. § 202(a)(1)(A)(v). A person who recklessly discloses a determination or petition of the Secretary must be fined not more than $250,000, or imprisoned for up to 5 years, or both. § 202(a)(1)(C).	
Reporting requirements	The Bankruptcy Court issues orders and final judgments, which are public documents.	The Secretary must provide written notice of the appointment of the FDIC as receiver to the Majority and Minority Leaders of the Senate, the Speaker and the Minority Leader of the House of Representatives,	If the FDIC suspends dividends from excess amounts in the Deposit Insurance Fund, the FDIC must submit such determination to the Committee on Banking, Housing, and Urban

		the Committee on Banking, Housing and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives within 24 hours after time of commencement. § 203(c)(2). Within 60 days after the time of appointment of the FDIC as receiver, the FDIC must file a report with the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives (i) setting forth information on the financial condition of the CFC, (ii) describing the plan and actions taken by the CFC, (iii) explaining each instance in which the FDIC waived any applicable requirements of part 366 of title 12, (iv) describing the reasons for the provisions of any funding to the receivership of the Fund (defined below), (v) setting forth the expected costs of the liquidation of the CFC, (vi) setting forth the identity of any claimant treated differently than similarly situated claimants; and (vii) which report the FDIC must publish online. § 203(c)(3)(A). The FDIC and the primary financial regulatory agency, if any, of the financial company for which the FDIC was appointed receiver under this title must appear before Congress, if requested, not later than 30 days after the date on which the FDIC first files the reports required by § 203(c)(3)(A). § 203(c)(3)(C). The Comptroller General of the U.S. must review and report to Congress any determination to use the resolution authority. § 203(c)(5). The FDIC must maintain a full accounting of each receivership or other disposition of any CFC. The FDIC must file an annual report to the Secretary and the Comptroller General, which must be made available to the public. § 210(a)(16). The Administrative Office of the U.S. Courts and the Comptroller General of the U.S. must conduct separate studies regarding the orderly liquidation process for financial companies under the Bankruptcy Code. § 202(e). The Comptroller General of the U.S. must conduct a	Affairs of the Senate and the Committee on Financial Services of the House of Representatives within 270 days after making such determination. Pub. L. No. 109-173, § 5, Feb. 15, 2006, 119 Stat. 3606.

		study regarding international coordination relating to the orderly liquidation of financial companies under the Bankruptcy Code. § 202(f). The Comptroller General of the U.S. must conduct a study regarding the implementation of the prompt corrective action by the appropriate federal banking agencies. § 202(g).	
Funding	There is no provision for statutory government funding. Subject to Bankruptcy Court approval, the company may use its available cash or obtain post-petition funding to provide for its funding requirements during the reorganization process. Such funds are provided by third-party lenders. If necessary, the Bankruptcy Court can authorize the debtor to grant the debtor-in-possession (the "DIP") lender a priming lien, which has priority over pre-bankruptcy liens and is a claim with super-priority over administrative expenses incurred during chapter 11 and over all other claims.	The Act creates a separate Orderly Liquidation Fund (the "Fund"), which is available to the FDIC for the orderly liquidation of the CFC. §§ 210(n)(1) and 204(d). The Fund is likely to be initially established when the FDIC is appointed as receiver of a CFC through FDIC-issued debt obligations bought by the Secretary. §§ 210(n)(5) and (o)(1)(B). The FDIC may issue obligations to be sold to the Secretary, which the Secretary can then sell. § 210(n)(5). The FDIC may only issue debt obligations up to (i) an amount equal to 10 percent of the total consolidated assets of the CFC during the 30-day period immediately following the date of appointment of the FDIC as receiver (or a shorter time if the FDIC has calculated the fair value of the assets of the CFC) and (ii) the amount that is equal to 90 percent of the fair value of the total consolidated assets of each CFC that are available for repayment after the 30-day period following the appointment of the FDIC as receiver (or a shorter time if the FDIC has calculated the fair value of the assets of the CFC). § 210(n)(6). The FDIC would be required to repay its borrowings through proceeds received through the liquidation process and assessments on any claimant that received additional payments as a result of its unequal treatment by the FDIC to minimize losses to the FDIC in the orderly liquidation process, unless such payments were necessary to initiate and continue operations essential to the implementation of the receivership or any bridge financial company. §§ 210(n)(2) and (o)(1)(D). Such assessment would equal the amount the claimant received from the	Financial assistance is funded from the deposit insurance fund. 12 U.S.C. § 1821(a)(4). The FDIC, in seeking to provide assistance to an institution or other prescribed actions, must determine that such action is necessary and will incur the least cost to the FDIC. 12 U.S.C. § 1823(c)(4). The FDIC may borrow money from the Treasury for funding the insurance fund. The FDIC may also sell its obligations to the Federal Financing Bank and also borrow from insured depository institutions and federal home loan banks. 12 U.S.C. § 1824. The FDIC Board of Directors (the "Board") sets assessments by considering: the FDIC's operating costs, estimated case resolution expenses and income, the projected effects of the payment of assessments on institutions, risk factors under the risk-based assessment system and other factors the Board deems appropriate. 12 U.S.C. § 1817(b)(2)(B). Risk factors in the "risk-based" assessment system are based on the probability the FDIC will incur a loss from an institution, the likely amount of loss and the revenue needs of the FDIC. 12 U.S.C. § 1817(b)(1)(C). An institution is not barred from the lowest-risk category in the risk-based assessment system solely because of its size. 12 U.S.C. § 1817(b)(2)(D).

		FDIC minus the amount the claimant was entitled to recover solely from the liquidation of the CFC under Title II (or the amount the claimant would have received from a chapter 7 liquidation under the Bankruptcy Code). § 210(o)(1)(D). If assessments on claimants are insufficient to recoup the Fund's expenditures, the FDIC must impose assessments on bank holding companies and financial companies with total consolidated assets equal to or greater than $50 billion and nonbank financial companies supervised by the Fed. § 210(o)(1)(D). When replenishing the Fund through proceeds from the liquidation process, such amount owed to the Fund must have priority among all administrative claims and amounts owed to the United States under the priority scheme established for unsecured claims in section 210(b)(1). § 204(d). The FDIC must charge one or more risk-based assessments if such assessments are necessary to pay in full the obligations issued by the FDIC to the Secretary within 60 months of the date of issuance of such obligations. § 210(o)(1)(B). Assessments are imposed on a graduated basis; financial companies with greater assets will be assessed at a higher rate. § 210(o)(2). When imposing assessments, the FDIC must consider several listed factors, including the economic conditions generally affecting financial companies, assessments imposed on the company under the FDIA, SIPC, Federal Credit Union Act or applicable State law for insurance companies, the risks presented by the financial company to the financial system and the extent to which the financial company has benefitted, or likely would benefit, from the orderly liquidation of a financial company under this title, any risks presented by the financial company during the 10-year period prior to the appointment of the FDIC as receiver that contributed to the failure of the CFC and such other factors as the FDIC, and such other risk-related factors as the FDIC or Financial Stability Oversight Council (the "Council") deems appropriate. § 210(o)(4).	

		If the FDIC, as receiver, cannot obtain unsecured credit for the CFC from commercial sources, the FDIC may obtain credit or incur debt for the CFC which must have priority over any or all administrative expenses of the receiver. § 210(b)(2).	
Management	In chapter 11, the board and management of the debtor continue to operate the company as a DIP and are entitled to propose a plan for the reorganization or the liquidation of the debtor. Under certain circumstances, a trustee may be appointed. 11 U.S.C. §§ 322 and 1104. In a chapter 7 case (bankruptcy liquidation), a trustee administers the liquidation of the assets of the debtors. 11 U.S.C. §§ 322, 701, 702, 703.	Upon the Court issuing an order for the Secretary to appoint the FDIC as receiver, the Secretary must appoint the FDIC as receiver. § 202(a)(1)(A)(iv). As the receiver, the FDIC is the liquidator of the financial company. § 204(a). The FDIC may create a bridge financial company (a "Bridge Company"). § 210(a)(1)(F). The appointment of the FDIC as receiver must terminate in 3 years after the date of the FDIC's appointment as the receiver. § 202(d)(1). The time limit for the FDIC as receiver can be extended for up to one additional year if the Chairperson of the FDIC certifies in writing that the continuation of the receivership is necessary to maximize the return or minimize the losses in the liquidation of the CFC and to protect the stability of the U.S. financial system. § 202(d)(2). The time limit can be further extended for an additional year if the conditions under § 202(d)(2) are met and FDIC submits a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives describing that includes the reasons for a second extension and a specific plan for concluding the receivership. § 202(d)(3).	An institution's charter determines which agency appoints the receiver. The FDIC may appoint itself the sole receiver or conservator. 12 U.S.C. § 1821(c)(4). As a conservator, the FDIC takes operational control of the company to preserve it. 12 U.S.C. § 1821(c)(2)(A)(i). Similar to chapter 11 bankruptcy. As a receiver, the FDIC is the liquidator of the company. 12 U.S.C. § 1821(c)(2)(A)(ii).
Rulemaking authority	Congress alone amends the Bankruptcy Code, with the federal judiciary to prescribe the rules of practice, procedure and evidence for the federal courts, subject to the right of Congress to reject, modify or defer any Bankruptcy Rules that have been adopted. The various bankruptcy courts may enact their own Local Rules. The FRBP governs procedural aspects of a case.	The FDIC must, in consultation with the Council, prescribe such rules and regulations as the FDIC considers necessary or appropriate to implement this title. § 209. The Court must establish such rules and procedures as may be necessary to ensure the orderly conduct of proceedings, including rules and procedures to ensure that the 24-hour deadline is met and that the Secretary must have an ongoing opportunity to amend and re-file petitions. § 202(b).	The FDIC may prescribe such regulations as the FDIC determines to be appropriate regarding the conduct of conservatorships or receiverships. 12 U.S.C. § 1821(d)(1).

		The FDIC may prescribe rules to establish an interest rate for creditors holding proven claims against the receivership estates of a CFC. § 210(a)(7)(D). The SEC and FDIC, after consultation with the SIPC, must jointly issue rules to implement the orderly liquidation of a CBD. § 205(h). The FDIC must, in consultation with the Secretary, impose rules and regulations to administer assessments. § 210(o)(6). The FDIC must promulgate regulations on the recoupment of compensation from executives and directors due to their responsibility for the failed condition of a CFC. § 210(s)(3).	
Coordination with other Regulators	No obligation.	The FDIC, as receiver, must consult with the primary regulators of the CFC and its covered subsidiaries and the primary regulators of any subsidiaries of the CFC that are not covered subsidiaries. § 204(c)(1) and (3). The FDIC must consult with the SEC and SIPC for a covered broker or dealer for the purpose of determining whether to transfer customer accounts of the CFC without consent of any customer to a Bridge Company. § 204(c)(4). The FDIC may consult with outside experts as appropriate. § 204(c)(2).	No obligation.
Power of the DIP/ FDIC/Trustee	The trustee or DIP is the successor in interest to the rights, title, assets and affairs of the debtor and can manage them in the ordinary course of business. The DIP/trustee also obtains the books and records of the debtor. The DIP or trustee must seek the approval of the Bankruptcy Court for any transactions that are deemed "outside the ordinary course of business," including one-off transactions such as post-petition loans and the sale of significant operating assets. Court approval for transactions "outside the ordinary course of business" is determined	The FDIC, as receiver, succeeds to the: • rights, titles, powers and privileges of the CFC and of any stockholder, member, officer or director of the CFC and its assets and • title to the books, records, and assets of any previous receiver or legal custodian of the CFC. § 210(a)(1)(A). During the orderly liquidation, the FDIC, as receiver, will operate the CFC and may take the following actions:	The FDIC, as conservator or receiver, succeeds to the company's: • rights, titles, powers and privileges of the company and of any stockholder; and • title to the books, records and assets of any previous receiver. 12 U.S.C. § 1821(d)(2)(A). The FDIC, as conservator or receiver, may: • take over the assets and operate the company;

	by the best-interest-of-the-estate standard. The DIP/trustee is a fiduciary for the creditors and shareholders of the company and is required to comply with significant operating and reporting requirements under the Bankruptcy Code, the FRBP and the Local Rules of the relevant jurisdiction. The DIP/trustee is required, among other things, to: • perform all functions of the company in the company's name; • collect all assets, obligations and money due to, and collect and evaluate claims against, the estate; • preserve and conserve the assets and property of the estate; • pay all expenses arising post-petition, including wages, and taxes; • maintain insurance, as directed by the UST; • close pre-petition accounts and open at least one post-petition account, which indicates that the debtor is operating as a DIP, at a bank that agrees to comply with the UST reporting requirements; • file schedules, creditors matrices (with addresses for notification) and statements of financial affairs (these are generally publicly available but can be filed under seal (FRBP 1007)); • file operating reports with the UST pursuant to FRBP 2015(a)(3); and • notify creditors of the bankruptcy proceeding and major	• take over the assets and operate the CFC; • collect all obligations and money due to the CFC; • perform all functions of the CFC in the company's name; • manage the assets and property of the CFC; • provide by contract for assistance in fulfilling any function, activity, action or duty of the receiver; • merge the CFC with another company; • provide for the exercise of any function by any member or stockholder, director or officer of the CFC; • organize a Bridge Company; or • transfer any asset or liability of the CFC without any approval, assignment or consent with respect to such transfer. § 210(a)(1)(B)-(G). The FDIC, as receiver, must liquidate and wind-up the CFC. § 210(a)(1)(D). Upon the appointment of the FDIC as receiver for any CFC that is a CBD, the SIPC must be appointed as trustee to liquidate the CBD. § 205(a). **A.** Upon its appointment as trustee by the FDIC, the SIPC must have all of the powers and duties provided by the Securities Investor Protection Act (the "SIPA") as to the CBD, but must have no powers or duties with respect to assets and liabilities transferred by the FDIC from the CBD to a Bridge Company. § 205(b)(1). The SIPC must promptly file an application for a protective decree under the SIPA with any Federal district court of competent jurisdiction, which the district court must approve. § 205(a)(2)(A). The SIPC must administer the determination of claims and liquidation of assets of the CBD that were not transferred to a Bridge Company. § 205(a)(2)(B).	• collect all obligations and money due to the company; • perform all functions of the company in the company's name; and • preserve and conserve the assets and property of the company. 12 U.S.C. § 1821(d)(2)(B). Typically, the FDIC arranges a purchase-and-assumption ("P&A") transaction for insured (or all) deposits and some assets with a healthy bank at the time a receivership is established. The FDIC can: • prescribe, • make loans to, • make deposits in, • purchase the assets or securities of, • assume the liabilities of, • or make contributions to any insured depository institution if such action (a) is taken to prevent the default of such institution, (b) is taken to restore the institution to normal operations or (c) will decrease the threat of instability to several such institutions, so long as the FDIC uses the least costly resolution. 12 U.S.C. § 1823(c). FDIC can merge or transfer any asset or liability in default without any approval, assignment, or consent, and is not bound by non-assignability provisions. 12 U.S.C. § 1821(d)(2)(G). Relief is limited to damages. The FDIC can provide assistance to the institution before the appointment of a conservator or receiver, as long as it is the least costly resolution. 12 U.S.C.

	developments. The DIP/trustee may not do the following, among other things, without Bankruptcy Court approval: • pay pre-petition debts; • pay professionals and advisors without a Bankruptcy Court order; • sell assets outside the ordinary course of business (11 U.S.C. § 363 and FRBP 4001); • use cash collateral without the consent of secured creditors or the Bankruptcy Court (11 U.S.C. § 363(c)(2)); and • obtain credit or incur secured or unsecured debt without Court approval (11 U.S.C. § 364 and FRBP 4001).	**B.** The SIPC's exercise of powers and functions as trustee must not impair or impede the exercise of the powers and duties of the FDIC with regard to: • any action to (i) make funds available under § 204(d), (ii) operate or terminate any Bridge Company, (iii) transfer assets and liabilities, (iv) enforce or repudiate contracts and (v) take any other actions relating to such Bridge Company; or • determining claims under § 205(e). § 205(b)(2). No action taken by the FDIC with respect to a CBD may adversely affect the rights, claims and recoveries of a customer to customer property, diminish the amount of timely payment of net equity claims or otherwise impair recoveries under the SIPA. § 205(d)(1). In taking any action under the Act, the FDIC must (i) determine that such action is necessary for purposes of financial stability of the U.S. and not for the purpose of preserving the CFC; (ii) ensure that the shareholders of a CFC do not receive payments until after all other claims and the Fund are fully paid; (iii) ensure that unsecured creditors bear losses in accordance with the priority of claim provisions under the Act; (iv) ensure that the management responsible for the failed conditions of the CFC is removed; (v) ensure that the members of the board responsible for the failed condition are removed; and (vi) not take an equity interest in or become a shareholder of any CFC or any covered subsidiary. § 206. Unlike the FDIA, there is no provision in the Act that requires the FDIC to seek the least costly resolution. The FDIC may use the Fund for (i) making loans to, or purchasing any debt obligation of, the CFC or any covered subsidiary; (ii) purchasing or guaranteeing against loss the assets of the CFC or any covered subsidiary, directly or through an entity established by the FDIC for such purpose; (iii) assuming or	§ 1823(c)(8) and (c)(4). The conservator or receiver can offer any asset of the institution for sale to the FDIC or as security for loans from the FDIC. 12 U.S.C. § 1823(d). Proceeds from such sale or loan are used to pay the institution's claims. The FDIC can conduct certain emergency acquisitions if severe financial conditions threaten the stability of a significant number of savings associations or savings associations with a significant amount of resources, without meeting the least cost resolution test, under the terms and as authorized under 12 U.S.C. § 1823(k).

		guaranteeing the obligations of the CFC or any covered subsidiary to 1 or more third parties; (iv) taking a lien on any or all assets of the CFC or any covered subsidiary, including a first priority lien on all unencumbered assets of the CFC or any covered subsidiary to secure repayment of any transactions conducted under this subsection; (v) selling or transferring all, or any part, of such acquired assets, liabilities, or obligations of the CFC or any covered subsidiary; and (vi) making payments pursuant to sections 210(b)(4), (d)(4), and (h)(5)(E). § 204(d)(1)-(6).	
Foreign investigations	A trustee or DIP may be authorized by the Court to act in any foreign country on behalf of an estate. 11 U.S.C. § 1505. A foreign representative can also apply for recognition of foreign proceedings and can attain access to federal bankruptcy proceedings. 11 U.S.C. §§ 1515 and 1509. Chapter 15 of the Bankruptcy Code contains provisions relative to proceedings in foreign jurisdictions and the rights of foreign representatives to appear and be heard in U.S. bankruptcy courts.	The FDIC must coordinate with the appropriate foreign financial authorities regarding the orderly liquidation of subsidiaries of CFCs that have assets and operations in a country other than the U.S. § 210(a)(1)(N). The FDIC may request the assistance of any foreign financial authority, provide assistance to any foreign financial authority and maintain an office to coordinate foreign investigations for the purpose of carrying out any power, authority or duty with respect to a CFC. § 210(k). The provisions of the Act are substantially similar to those of the FDIA.	The FDIC may request the assistance of any foreign financial authority and provide assistance to any foreign financial authority. The FDIC may also maintain an office to coordinate foreign investigations. 12 U.S.C. § 1818(v).
Judicial review of DIP/FDIC/ trustee's actions	The Bankruptcy Court must approve all out-of-the-ordinary-course actions by the DIP/trustee. In addition, any creditor or the UST can file a motion or objection with respect to certain actions in the bankruptcy case. The DIP/trustee may object to any creditor's proof of claim, for cause. FRBP 3007. The Bankruptcy Court, after notice and a hearing, determines the nature and amount of such claim as a contested matter. 11 U.S.C. § 502(b). The Bankruptcy Court has jurisdiction over adversary proceedings, which are actions that cannot be handled by motion in the	To appoint the FDIC as receiver without the consent of the CFC's board of directors, the Secretary must petition the Court for an order authorizing the Secretary to appoint the FDIC as receiver. § 202(a)(1)(A)(i). The Court, after a hearing in which the CFC may oppose the petition, must determine whether the finding of the Secretary that the CFC is in default or in danger of default and satisfies the definition of a financial company under section 201(a)(11) is arbitrary and capricious. § 202(a)(1)(A)(iii). If the Court finds the Secretary's determination is not arbitrary and capricious, the Court must issue an order immediately authorizing the Secretary to appoint the FDIC as receiver for the CFC. If the Court finds that the Secretary's determination is arbitrary and capricious, the Court	The company may bring an action in U.S. District Court within 30 days of the appointment of a conservator or receiver to challenge the appointment of the conservator or receiver. 12 U.S.C. § 1821(c)(7). Claimants can request a judicial determination or an administrative hearing to review the FDIC's determinations. Final determinations in administrative hearings are subject to judicial review. 12 U.S.C. § 1821(d)(6). There are inconsistent sections related to the availability of judicial review over claims determinations made by the FDIC in 12 U.S.C. § 1821(d). However, cases interpreting these sections suggest that

	bankruptcy case, but instead require the filing of a separate complaint. FRBP 7001 lists types of actions that require an adversary proceeding.	must immediately provide the Secretary with a written statement of the reasons for its determination, and afford the Secretary an immediate opportunity to amend and refile the petition. § 202(a)(1)(A)(iv). Appeals from the Court's decision to the United States Court of Appeals for the District of Columbia Circuit must be on an expedited basis and filed by the Secretary or the board of directors of the CFC no more than 30 days after the Court's decision is rendered. The Court of Appeals must have jurisdiction of an appeal only if the CFC did not consent to the appointment of the FDIC as receiver; such appeal must be limited to whether the determination of the Secretary that the CFC is in default or in danger of default and that the CFC is a financial company is arbitrary and capricious. The Secretary or the board of directors may petition for a writ of certiorari to the Supreme Court 30 days after the final decision of the Court of Appeals; such appeal is limited to whether the determination of the Secretary that the CFC is in default or in danger of default and that the CFC is a financial company is arbitrary and capricious. § 202(a)(2). The notice of appeal of any order, entered in any case brought by the FDIC against a CFC's director, officer, employee or any other person employed by or providing services to such company, must undergo expedited procedures and be filed not later than 30 days after entry of the order. The hearing of the appeal must not be later than 120 days after the date of the notice of appeal and must be decided no later than 180 days after the date of the notice of appeal. The court may modify these periods in the interest of justice. § 210(j). A claimant may contest a claim determination by the FDIC in the district court for the district where the principal place of business of the CFC is located. § 210(a)(4)(A). No court may take any action to restrain or affect the exercise of powers or functions of the receiver hereunder, unless specifically provided for in the Act, and any remedy against the FDIC or receiver must be	judicial review is available after exhaustion of the administrative claim process with the FDIC. Unless otherwise provided, no court has jurisdiction over any action for payment from, or determination of rights with respect to, the assets of any company for which the FDIC has been appointed as its receiver, or any claim relating to any act or omission of the company or FDIC as receiver. 12 U.S.C. § 1821(d)(13)(D). An appeal of any order, entered in any case brought by the FDIC against a company's director, officer, employee or any other person employed by or providing services to such company, must undergo expedited procedures and be filed within 30 days after entry of the order and heard 120 days after the date of the notice of appeal. 12 U.S.C. § 1821(q). No court may issue an attachment or execution over the assets that are in the possession of the FDIC as receiver. 12 U.S.C. § 1821(d)(13)(c).

		limited to money damages determined in accordance with the Act. § 210(e). Similar provisions apply to CBDs under § 205.	
Suspension of other legal actions	Once a bankruptcy petition is filed, all other judicial, administrative or other actions or proceedings (with the exception of certain police and regulatory proceedings) against the debtor are automatically, and without the need for a specific request, stayed. No such actions can proceed without the Bankruptcy Court lifting the automatic stay, which remains in place until the case is dismissed or closed. 11 U.S.C. § 362. The automatic stay applies to non-judicial actions, including the enforcement of a judgment, any act to obtain possession of property of the estate, any act to create, perfect, or enforce any lien against property of the estate, any act to collect, assess or recover a pre-petition claim, and the setoff of any pre-petition debt against any claim against the debtor. The automatic stay terminates when the property is no longer part of the estate, the Court lifts the stay, or the case is dismissed or closed. 11 U.S.C. § 362.	The FDIC's placement as receiver terminates any bankruptcy court or SIPC case or proceeding commenced with regards to the CFC, and no such case or proceeding may be commenced with respect to the CFC while an orderly liquidation is pending. § 208(a). The rights of the FDIC to recover assets from avoidable transfers supersede the rights of any trustee in bankruptcy or any other person under the Bankruptcy Code. § 210(a)(11)(G). Any assets of the CFC which vested in another entity as a result of any proceeding commenced with respect to the CFC under the Bankruptcy Code or SIPA must revest in the CFC. § 208(b). Upon the request by the FDIC, any court where a judicial action is pending to which the CFC is or becomes a party must grant a stay to all parties for 90 days. § 210(a)(8).	The FDIC can direct a court to temporarily stay any judicial action, criminal or non-criminal. 12 U.S.C. § 1821(d)(12).
Revival of claims	The DIP/trustee has the power to bring lawsuits and avoidance actions, including fraudulent conveyance and preference claims, but cannot revive claims where the statute of limitations has expired before the filing. The Bankruptcy Code contains provisions for extending the statute of limitations, commencement of actions and response dates but only if those periods have not expired when the bankruptcy case is filed. 11 U.S.C. § 108.	The FDIC can bring an action on certain tort claims where the state statute of limitations has expired not more than 5 years before the appointment of the FDIC as receiver. The claim must arise from fraud, intentional misconduct resulting in unjust enrichment or intentional misconduct resulting in substantial loss to the CFC. § 210(a)(10)(C). The provisions of the Act are substantially similar to those of the FDIA.	Within 5 years of the appointment of the FDIC as receiver or conservator, the FDIC can bring an action on certain tort claims even though the state statute of limitations has expired. The claim must arise from fraud, intentional misconduct resulting in unjust enrichment or intentional misconduct resulting in substantial loss to the eligible institution. 12 U.S.C. § 1821(d)(14)(c).
Director and officer liability	Directors and officers of a company owe fiduciary duties to the company. When the company is solvent, shareholders can bring	Directors are not liable to the shareholders or creditors for acquiescing or consenting in good faith	Directors and officers are not liable for acquiescing to the appointment of the FDIC and acquisitions, combinations or transfers of

	an action for breach of those duties. When the company is insolvent, creditors can also bring an action for breach of those duties. Directors can be held liable for taking actions that are not in the best interest of the estate or for failing to take actions that are in the best interest of the estate. Failing to file a bankruptcy case to protect valuable assets of the company may be the basis of a breach of fiduciary duty claim.	to the appointment of the FDIC as receiver. § 207. Directors and officers of a CFC may be held personally liable for monetary damages in any civil action for gross negligence, including intentional tortious conduct, as defined under applicable state law. § 210(f). In claim proceedings involving any director, employee, officer, agent, attorney, accountant, appraiser or other service provider, recoverable damages due to "improvident or otherwise improper use or investment" of any assets include principal losses and appropriate interest. § 210(g). The FDIC can recover from any current or former executive or director substantially responsible for the failed condition of the CFC any compensation received from 2 years prior to appointment of the FDIC as receiver. In cases of fraud, no time-limit would exist for the FDIC's ability to recover such compensation. § 210(s)(1). The provisions of the Act are substantially similar to those of the FDIA.	assets taken by the FDIC. 12 U.S.C. § 1821(c)(12). Directors and officers may be personally liable for actions for gross negligence or "intentional tortious conduct." 12 U.S.C. § 1821(k). In claims proceedings involving any director, employee or service provider, damages due to "improvident or otherwise improper use or investment" of any assets include principal losses and interest are recoverable. 12 U.S.C. § 1821(l).
Creditor claims	The DIP/trustee cannot unilaterally disallow any claim or portion of a claim. The DIP/trustee will file a list of creditors and their claims and, in addition, receive and evaluate claims submitted by creditors. Claims are deemed allowed unless contested. If contested, the Bankruptcy Court, after notice and a hearing, determines the nature and amount of such claim as a contested matter, and may allow or disallow some or all of any such claim. 11 U.S.C. § 502.	The FDIC, as receiver, may determine claims by creditors. § 210(a)(2)(A). The FDIC must determine whether to allow or disallow a claim within 180 days of the filing of such claim with the FDIC. § 210(a)(3)(A)(i). The FDIC may object to any portion of any claim that is not proved to the FDIC's satisfaction. § 210(a)(3)(D)(i). Credit extensions from the Federal Reserve or the Treasury to a CFC and any legally enforceable and perfected security interest with respect to such credit extensions must not be disallowed. § 210(a)(3)(D)(iii). The FDIC, as receiver, must establish procedures for expedited relief for a claimant that alleges the existence of a legally valid, enforceable or perfected security interest for which they will suffer irreparable harm if resolved under the normal claim procedures. § 210(a)(5)(A). The FDIC must determine within 90	The FDIC may allow or disallow any claim as a receiver. 12 U.S.C. § 1821(d)(5). The FDIC may disallow any portion of the claim that is not proved to the FDIC's satisfaction. 12 U.S.C. § 1821(d)(5)(D). See Judicial Review above for the limited role of the court in the claims process.

		days of the filing for expedited relief whether to allow or disallow such claim or whether such claim should be determined pursuant to the normal procedures for claims. § 210(a)(5)(B).	
Post-commencement claims	Post-petition claims are treated as administrative claims and paid in full no later than the effective date of the plan; post-petition claims are paid before pre-petition claims.	Final judgment for money damages against the FDIC for contracts executed or approved after the date of the FDIC's appointment must be paid as an administrative expense (the highest priority for unsecured claims). § 210(a)(15). The provisions of the Act are substantially similar to those of the FDIA.	Final judgment for money damages against the FDIC for contracts executed or approved by the conservator or receiver after the date of its appointment must be paid as an administrative expense. 12 U.S.C. § 1821(d)(20).
Claims preceding commencement	The payment of pre-petition claims is generally done through the plan of reorganization, although the Bankruptcy Court can permit early payment of certain pre-petition claims, such as critical vendor claims, if that is in the best interest of the estate. The Bankruptcy Code sets out the priority of distributions and how much a class of creditors must receive before distributions may be made to a more junior class. In a chapter 11 reorganization, creditors may receive considerably more than liquidation value as the value of a business as a going concern may greatly exceed its liquidation value.	The FDIC, as receiver, must pay all valid obligations of the CFC that are due and payable at the appointment of the FDIC as receiver, in accordance with the limitations of the Act. § 210(a)(1)(H). This is subject to the limitation in § 210(d)(2) that the maximum liability is capped at the amount a claimant would have received if the CFC had not been the subject of a determination under the Act and had been liquidated under chapter 7 of the Bankruptcy Code (claims are valued at face but are only paid to the extent money is available at that priority level) (hereinafter, the "Liquidation Amount"). The maximum liability of the FDIC, as receiver of a CBD, must equal the amount such customer would have received in a case initiated by the SIPC under the SIPA, determined as of the close of business on the date the FDIC is appointed as receiver. § 210(d)(3).	Claims due and payable preceding commencement undergo the same process and are treated the same as other claims, with no mandate for payment. Uses the procedure of 12 U.S.C. § 1821(e).
Shareholder claims	Shareholders are entitled to recover a distribution if there are sufficient assets in the estate to pay in full claimants with a higher priority. While the debtor remains in possession in a chapter 11 case, it is managed by its board of directors and duly authorized officers. The directors and officers have to act in the best interest of the estate as a whole, however, as they also owe fiduciary duties to creditors in the insolvency context.	The Act terminates all rights and claims that stockholders and creditors of the corporation have against the assets of the company, except rights to payment, dissolution or other satisfaction of their claims as permitted under section 210, by operation of law on the appointment of the FDIC. The FDIC must ensure that shareholders and unsecured creditors bear losses, consistent with the priority of claims outlined in the Act. § 210(a)(1)(M).	Shareholder claims arising from their status as shareholders receive the lowest priority, after payment of other unsecured claims. 12 U.S.C. § 1821(d)(11).

Secured claims	Secured claims are secured up to the value of the collateral. An over-secured creditor's claim will include post-petition interest on the claim. 11 U.S.C. § 506. As noted below, the value of the collateral will be determined in light of the purpose of the valuation; thus, the valuation may differ depending on the context in which the valuation arises. Secured party's collateral can be used if there is a demonstration of adequate protection of the interest of such party.	The FDIC may object to any portion of any claim by a creditor or claim of a security, preference, set-off or priority which is not proved to its satisfaction. The FDIC cannot disallow a portion of a legally enforceable and perfected security interest securing an extension of credit from any Federal Reserve Bank or the Secretary. § 210(a)(3)(D)(i) and (iii)(II). Claims proven to the satisfaction of the FDIC are secured up to the fair market value of the collateral. § 210(a)(3)(D)(ii). The value of collateral in a liquidation may be significantly less than its value in a reorganization. The FDIC may not reject any legally enforceable or perfected security interest in the assets of the CFC (unless such interest was a fraudulent or preferential transfer) or legally enforceable interest in customer property. § 210(c)(12).	The FDIC may disallow all or part of any security not proved to its satisfaction, with the exception of any extension of credit from any federal home loan bank or Federal Reserve Bank to any insured depository institution; or any security interest in the assets of the institution securing any such extension of credit. § 1821(d)(5)(D)(i) and (iii). Claims proved to the satisfaction of the FDIC are secured up to the fair market value of the secured collateral and the amount a claimant would have received if the company had been liquidated under the FDIA. 12 U.S.C. § 1821(d)(5)(D)(ii)(I). The value of collateral in an FDIA liquidation may be significantly less than its value in a reorganization. Claims of federal home loan banks and secured claims are paid before unsecured claims. The FDIC may not avoid any legally enforceable or perfected security interest in any of the assets of any depository institution unless such interest was taken in contemplation of the institution's insolvency or with the intent to hinder, delay or defraud the institution or its creditors. 12 U.S.C. § 1821(e)(11).
Under-secured creditors	Generally, the portion of the claim that exceeds the value of the collateral is considered to be an unsecured claim and this portion has the same priority as other unsecured claims. 11 U.S.C. § 506. As noted above, the value of the collateral will be determined in light of the purpose of the valuation and may differ depending on the context.	The FDIC, as receiver, may treat the portion of any secured claim which exceeds the fair market value of such collateral as an unsecured claim, and may not make payment with respect to such unsecured portion other than in connection with a disposition of all unsecured claims. § 210(a)(3)(D)(ii). The provisions of the Act are substantially similar to those of the FDIA.	The portion of the claim that exceeds the fair market value of the collateral in a secured claim may be treated as an unsecured claim and this portion has the same priority as other unsecured claims. 12 U.S.C. § 1821(d)(5)(D)(ii).
Unsecured claims	Unsecured claims have the following priority in descending order:	Unsecured claims have the following priority, in descending order:	Depositors are given priority over general creditors. 12 U.S.C. § 1821(d)(11).

	• administrative expenses; • priority wage/commission claims ($10,950 per individual); • priority claims for employee benefit plans (shares the $10,950 cap above); • priority claims of governmental units; • priority claims based upon any commitment by the debtor to a Federal depository; and • general unsecured claims. 11 U.S.C. § 507. Similarly situated creditors are to be treated similarly under the plan, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest. 11 U.S.C. § 1123. Under section 105 of the Bankruptcy Code, the Bankruptcy Court has the power, under certain circumstances, to treat similarly situated creditors dissimilarly; e.g., by providing that critical vendors who agree to provide post-petition credit terms to a debtor may be paid in full for pre-petition claims.	• administrative expenses of the receiver; • any amounts owed to the U.S.; • wages, salaries, or commissions earned not later than 180 days before the date of appointment of the FDIC as receiver ($11,725 per individual); • contributions owed to employee benefit plans arising from services rendered not later than 180 days before the date of appointment of the FDIC as receiver ($11,725 per individual); • general or senior liabilities of the CFC; • obligations subordinated to general creditors; • any wages, salaries, or commissions owed to senior executives and directors of the covered financial company; • obligations to persons with interests in the equity of the CFC as a result of their status as a shareholder, member, etc. § 210(b)(1). This priority scheme applies to claims of CBDs other than claims for the allocation of customer property and the delivery of customer name securities (which the SIPC must resolve in accordance with the SIPA). § 205(g). Where the FDIC is appointed as receiver for a CBD, unsecured claims against such CBD that are proven to the satisfaction of the receiver under § 205(e) must have the priority prescribed in § 210(b)(1) except that: • the SIPC must be entitled to recover administrative expenses on an equal basis with the FDIC; • the FDIC must be entitled to recover any amounts paid to customers or the SIPC which are liabilities owed to the U.S.; • the SIPC must be entitled to recover any amounts paid out of the SIPC Fund to meet	Unsecured claims have the following priority, in descending order: • administrative expenses; • deposit liability claims; • other general or senior liabilities; • subordinated obligations; and • shareholder claims. 12 U.S.C. § 1821(d)(11). Cases have construed the FDIA to require the ratable treatment of similarly situated creditors, up to the maximum liability set out in 12 U.S.C. § 1821(i)(2).

		its obligations, which claim must be subordinate to administrative expenses and liabilities owed to the U.S., but senior to all other claims; and • the FDIC may, after paying any proven claims to customers, pay dividends on other proven claims in its discretion with the priorities set forth in § 210(b)(1). § 210(b)(6). Unsecured claims of the U.S. must have a higher priority than liabilities of the CFC that count as regulatory capital. § 210(b)(3). Similarly situated creditors for each type of unsecured claim must be treated similarly unless the FDIC determines that the treatment is necessary to maximize the value of the CFC's assets, initiate and continue operations essential to implementation of the receivership or any Bridge Company, maximize the present value return from the sale of assets or minimize the losses of the CFC's assets. § 210(b)(4)(A). All similarly situated creditors must receive not less than the Liquidation Amount under § 210(d)(2) and (3). § 210(b)(4). "Administrative expenses" include any obligations that the receiver determines are necessary and appropriate to facilitate the smooth and orderly liquidation of the CFC. § 201(a)(1).	
Set-off Rights	A creditor can enforce its rights under applicable law to offset a mutual debt owing to the debtor against a claim against the debtor, subject to certain exceptions. The Bankruptcy Code provides that a creditor is not entitled to (i) set off a claim that was transferred to the creditor by an entity other than the debtor after the commencement of the case, or within 90 days before the filing of the petition and while the debtor was insolvent or (ii) set off a debt owed to the debtor if the debt was incurred (A) within 90 days of the bankruptcy filing, (B) while the debtor was insolvent, and (C) for the purpose	A creditor may enforce its rights under applicable law to offset a mutual debt owed by the creditor to the CFC that arose before the FDIC was appointed as receiver, unless: • the claim of the creditor is disallowed; • the claim was transferred, by an entity other than the CFC, to the creditor after the FDIC was appointed as receiver or after 90 days before the date on which the FDIC was appointed as receiver and while the CFC was insolvent (except for a set-off in connection with a qualified financial contract (a	The FDIA does not include specific protections for set-off rights under applicable law, however case law under the FDIA has established that set-off rights under applicable state law will be enforceable. The FDIA includes protections for the exercise of contractual rights to set off or net any termination values or payment amounts due in connection with a QFC.

	of obtaining a right to set-off against the debtor. See 11 U.S.C. § 553(a). This limitation does not apply to the exercise of contractual rights to set off or net any termination values or payment amounts due in connection with a QFC. See 11 U.S.C. §§ 560 and 561.	"QFC")); or • the debt owed to the CFC was incurred by the CFC after 90 days before the date on which the FDIC was appointed as receiver, while the CFC was insolvent and for the purpose of obtaining a right of set-off against the CFC (except for a set-off in connection with a QFC). § 210(a)(12)(A). Other than a set-off in connection with a QFC, if a creditor offsets a debt on or within 90 days before the FDIC was appointed as receiver, then the FDIC may recover from the creditor the amount so offset to the extent that any insufficiency on the date of such set-off is less than the insufficiency on the later of 90 days before the FDIC was appointed as receiver and the first day during the 90 days immediately preceding the date on which the FDIC was appointed as receiver for the CFC on which there is an insufficiency. § 210(a)(12)(B). The FDIC may object to any portion of any set-off which is not proven to its satisfaction. § 210(a)(3)(D)(i). Except as otherwise provided in the Act, the FDIC, as receiver for the CFC, may sell or transfer any assets free and clear of the set-off rights of any party. Such party must be entitled to a claim in an amount equal to the value of such set-off rights that will be junior to certain priority claims but senior to other general or senior liabilities of the CFC. § 210(a)(12)(F).	
Payment of claims	All claims are paid pursuant to the terms of the confirmed plan. Holders of secured claims may request relief from the automatic stay to foreclose on their collateral for cause or upon a demonstration that the debtor has no equity in the collateral and that it is not essential to the debtor's reorganization. 11 U.S.C. § 362. The general rule is that if senior classes consent to their distribution, junior classes may receive distributions so long as the	The FDIC may pay authorized claims allowed by the receiver, approved by the FDIC or determined by the final judgment of a court of competent jurisdiction. § 210(a)(7)(A). The receiver has the sole discretion to pay dividends on proven claims. No liability may attach for failing to pay dividends of an unproven claim. § 210(a)(7)(C). The FDIC may prescribe rules to establish an interest rate for, or to make payments of, post-insolvency interest to creditors holding proven claims. No such	Receiver may pay authorized claims allowed by the receiver, approved by the FDIC or determined by the final judgment of a court. 12 U.S.C. § 1821(d)(10)(A). The receiver has the sole discretion to pay dividends on proven claims. No liability may attach for failing to pay dividends on an unproven claim. 12 U.S.C. § 1821(d)(10)(B). The minimum requirement is that the claimant receive at least the amount that would be provided with the liquidation of the assets and

	members of such senior consenting classes receive at least as much as they would in a chapter 7 liquidation; however, if a class does not consent to its distribution, it is entitled to be paid in full before any junior class can receive any recovery. Certain pre-petition claims, such as those owed to employees and to the government for certain taxes, are afforded priority treatment. Priority pre-petition claims are paid after administrative claims but before payment of general unsecured claims.	interest must be paid until the FDIC, as receiver, has satisfied the principal amount of all creditor claims. § 210(a)(7)(D). If the FDIC, as receiver, enforces any contract to extend credit to the CFC or Bridge Company, any obligation to repay such debt must be paid as an administrative expense. § 210(c)(13)(D).	liabilities of the institution without a transfer of the assets or liabilities to a Bridge Company or the purchase of such assets or liabilities by the FDIC (such claims are valued according to the determinations of the FDIC but are only paid to the extent funds are available at that particular FDIC priority level). 12 U.S.C. § 1821(i)(2).
Disposition of assets	Ordinary course dispositions of assets, i.e., those dispositions that are in the ordinary course of the debtor's day-to-day business operations, may occur without Court approval. Sales outside the ordinary course must be approved by the Bankruptcy Court under 11 U.S.C. § 363 or the plan. 11 U.S.C. § 1123. Assets may be sold free and clear of all liens under 11 U.S.C. § 363 or the plan. Both types of sales are subject to Court approval under the "best interest of the estate" standard which seeks to maximize the value of the assets for the benefit of the estate.	In the disposition of assets, the receiver, to the greatest extent possible, must: • maximize its net present value return from the sale or disposition of assets; • minimize losses in the resolution of cases; • mitigate serious adverse effects to the financial system; • ensure competition and fair treatment; and • prohibit discrimination. § 210(a)(9)(E). The FDIC must prescribe regulations that prohibit the sale of assets of a CFC by the FDIC to parties who engaged in improper conduct with, or caused losses to, the CFC. § 210(r)(1). Persons convicted of certain crimes may not purchase assets from the FDIC as receiver. § 210(r)(2). The provisions of the Act are substantially similar to those of the FDIA, with the exception of the fact that the FDIC has no duty to maximize the availability and affordability of residential real property to low- and moderate-income individuals.	In the disposition of assets, a conservator or receiver <u>must</u>: • maximize its present value return from sale of assets; • minimize losses in the resolution of cases; • ensure competition and fair treatment; • prohibit discrimination; and • maximize the availability and affordability of residential real property to low- and moderate-income individuals. 12 U.S.C. § 1821(d)(13)(E). The FDIC <u>must</u> prescribe regulations which, at a minimum, prohibit the sale of assets of a CFC by the FDIC to parties who engaged in improper conduct with, or caused losses to, the CFC. § 210(r)(1). Persons convicted of certain crimes may not purchase assets from the FDIC as receiver. § 210(r)(2).
Maximum liability of the FDIC/DIP/ trustee	No creditor is entitled to be paid more than 100% of its claim, plus interest (if applicable). Any excess available after all creditors are paid such amount inures to the	Maximum liability of the FDIC is capped at the Liquidation Amount, or the amount a claimant would receive for their claims under chapter 7 of the Bankruptcy Code and if the FDIC had not been	Liability is capped at the amount claimant would receive in a liquidation of the institution without a transfer of the assets to a Bridge Company or the purchase of such assets by the FDIC (such claims are valued

	benefit of shareholders. A secured party receives the value of the collateral. The value of the collateral will be determined in light of the purpose of the valuation. Thus, value in the context of treatment under a reorganization plan may be determined to be far more than the liquidation value of such collateral.	appointed receiver. § 210(d)(2). For a CBD, the Liquidation Amount is equal to the amount a customer would have received from its customer property in a case initiated by the SIPC under the SIPA determined at the close of business on the day when the FDIC was appointed receiver. § 210(d)(3). The FDIC may, as receiver and with the approval of the Secretary, make additional payments or credit additional amounts to any claimant if necessary to minimize losses in the liquidation of the CFC. § 210(d)(4)(A). The FDIC must not make any such payments or credit amounts to any claimant or category of claimants that would result in any claimant receiving more than the face value amount of its claim. § 210(d)(4)(B)(i). When liquidating any CFC or Bridge Company that is or has a subsidiary that is a stockbroker but is not a member of the SIPC, the FDIC, as receiver, must apply the provisions of subchapter III of chapter 7 of the Bankruptcy Code for the distribution to any "customer" of all "customer name securities" and "customer property"; if the company is a commodity broker, the FDIC must apply the provisions of subchapter IV of chapter 7 of the Bankruptcy Code. § 210(m).	according to the determinations of the FDIC but are only paid to the extent funds are available at that particular FDIC priority level). 12 U.S.C. § 1821(i)(2).
Fraudulent conveyances	The DIP/trustee may avoid any transfer of an interest of the debtor in property, or any obligation by the debtor, made or incurred on or within 2 years before the date of the filing of the petition, if: (a) made with the intent to hinder or defraud a creditor (actual fraud); or (b) in exchange for the transfer, the debtor received less than "reasonably equivalent value," and the debtor was unable to pay debts either at the time the transfer was made or as a result of the transfer itself (constructive fraud). 11 U.S.C. § 548. The DIP/trustee can recover the property transferred, or the value of such property,	The FDIC, as receiver for any CFC, may avoid a transfer of any interest of the CFC in property, or any obligation incurred by the CFC, that was made or incurred on or within 2 years before the time of commencement of an orderly liquidation proceeding under this Act, if the CFC voluntarily or involuntarily (i) made such transfer or incurred such obligation with actual intent to hinder, delay or defraud the CFC, or received less than a reasonably equivalent value in exchange for such transfer or obligation; and (ii) was insolvent on the date that such transfer was made or became insolvent as a result of the transfer, was engaged in a transaction for which any property remaining with the CFC was an unreasonably small amount of capital, intended to incur debts that would be beyond the CFC's ability to pay as they matured;	The FDIC may avoid a transfer of interest that was made within 5 years of the date the FDIC was appointed as a conservator or receiver if the person who made the transfer did so with the intent to hinder, defraud or delay the institution, the FDIC or any other federal banking agency. 12 U.S.C. § 1821(d)(17)(A). Avoiding a fraudulent conveyance allows the FDIC to recover the property transferred or the value of the property from either the initial transferee or any immediate transferee of the initial transferee. 12 U.S.C. § 1821(d)(17)(B). The FDIC cannot recover from any transferee that takes for value, including satisfaction or securing of a present or prior debt, in good

	from the initial transferee or any immediate or mediate transferee of such initial transferee, unless the subsequent transferee took for value and without knowledge of the voidability of the transfer avoided. 11 U.S.C. § 550. The Bankruptcy Code also allows actions to be brought under applicable state fraudulent conveyance statutes if such actions are commenced within the applicable fraudulent conveyance statute of limitations. 11 U.S.C. § 544(b). The applicable statute of limitations under state statutes may be 4 years or more.	or made such transfer to or for the benefit of an insider under an employment contract and not in the ordinary course of business. § 210(a)(11)(A). The FDIC can recover the property transferred or value of the property (at the time of the transfer, with a court order) from the initial transferee or others in the chain of transfer. § 210(a)(11)(D). The FDIC cannot recover from any transferee that takes for value in good faith and without knowledge of the voidability of the transfer avoided or any immediate or mediate good faith transferee of such transferee. § 210(a)(11)(E). A transferee or obligee under the Act has the same defenses available to such transferee or obligee in an action brought under sections 547, 548 and 549 of the Code. As such, the defenses available under the Bankruptcy Code for fraudulent transfers appear to have been incorporated into the Act. § 210(a)(11)(F)(i). The FDIC's power to recover a transfer or avoid an obligation must include §§ 546(b) and (c), 547(c) and 548(c) of the Bankruptcy Code. § 210(a)(11)(F)(ii). The rights of the FDIC to recover assets from fraudulent transfers supersede the rights of any trustee in bankruptcy or any other person under the Bankruptcy Code. § 210(a)(11)(G).	faith or any immediate good faith transferee of such transferee. 12 U.S.C. § 1821(d)(17)(C). The avoidance rights of the FDIC are superior to any rights of a trustee or any other party. 12 U.S.C. § 1821(d)(17)(D).
Avoiding security interests and other preferential transfers	The Bankruptcy Code allows the avoidance of preferential transfers. A preference is a transfer of an interest of the debtor in property to or for the benefit of a creditor, on account of an antecedent debt, which was made while the debtor was insolvent, that enables such creditor to receive more than it would have otherwise received, if that transfer was made within 90 days before the date of the filing of the petition. This period is extended from 90 days to a year if the creditor was an "insider." 11 U.S.C. § 547. Preferential transfers may include payments of amounts due to existing creditors or grants of new security interests to secure	The FDIC, as receiver for any CFC, may avoid a transfer of an interest of the CFC in property (i) to or for the benefit of a creditor; (ii) for or on account of an antecedent debt; (iii) made while the CFC was insolvent; (iv) made 90 days before the date on which the FDIC was appointed receiver or between 90 days and 1 year before the date the FDIC was appointed receiver, if such creditor was an insider; and (v) that enables the creditor to receive more than the creditor would receive if the CFC had been liquidated under chapter 7 of the Bankruptcy Code, the transfer had not been made and the creditor received payment of such debt to the extent provided by chapter 7 of the Bankruptcy Code. § 210(a)(11)(B). The FDIC can recover the property transferred or	The FDIC cannot avoid any otherwise legally enforceable or perfected security interest in any of the institution's assets unless such interest was taken in contemplation of the institution's insolvency or with the intent to hinder, delay or defraud the institution or its creditors. 12 U.S.C. § 1821(e)(12).

	obligations owed to existing creditors. 11 U.S.C. § 547. Defenses include that the transfer was made for new value or in the ordinary course of business.	value of the property (at the time of the transfer, with a court order) from the initial transferee or others in the chain of transfer. § 210(a)(11)(D). The FDIC may avoid a transfer of property of the receivership that occurred after the FDIC was appointed receiver that was not authorized by the FDIC as receiver. § 210(a)(11)(C). A transferee or obligee under the Act has the same defenses available to such transferee or obligee in an action brought under sections 547, 548 and 549 of the Code. As such, the defenses available under the Bankruptcy Code for preferential transfers appear to have been incorporated into the Act. § 210(a)(11)(F)(i). The FDIC's power to recover a transfer or avoid an obligation include §§ 546(b) and (c), 547(c) and 548(c) of the Bankruptcy Code. § 210(a)(11)(F)(ii).	
Attachment of assets		The FDIC may request a court to issue an order (in accordance with Rule 65 of the Federal Rules of Civil Procedure) to place the assets of any person designated by the FDIC under the control of the court and appoint a trustee to hold such assets. §210(a)(13).	A Federal banking agency may issue a restraining order that prohibits a person from withdrawing, transferring, removing or disposing of any funds, assets or other property and appoint a temporary receiver to administer the restraining order. Rule 65 of the Federal Rules of Civil Procedure apply to any such proceeding for a restraining order. 12 U.S.C. § 1818(i)(4).
Contracts	A DIP/trustee may reject, assume or assume and assign to a third party the debtor's interest in pre-petition executory contracts (contracts where performance remains due on both sides), even if the debtor is in default under the contract at the time of the bankruptcy filing. If a debtor wishes to assume/assign an executory contract, it must "cure" all defaults, compensate for any damages sustained and provide adequate assurance of future performance. There are some executory contracts which cannot be assumed or assigned (without the consent of the non-debtor party) because they are financial accommodations contracts or	No agreement that diminishes or defeats the interest of the receiver in any asset is valid unless the agreement (i) is in writing, (ii) was executed by an authorized officer or representative of the CFC, or confirmed in the ordinary course of business by the CFC and (iii) has been an official record of the CFC since the time of its execution or the party claiming under the agreement provides documentation of such agreement and its authorized execution by the CFC. § 210(a)(6). These standards are similar to, though not as strict as, the parallel provisions of the FDIA. The FDIC may repudiate any contract or lease to which the CFC is a party, where contract performance is "burdensome" and the repudiation of	No agreement is valid against the FDIC's interest as receiver unless the agreement: • is in writing; • was executed contemporaneously with the acquisition of the asset by the institution and a counterparty; • was approved by the board of directors of the institution or its loan committee and the approval is reflected in the minutes of the board or committee; and • has been continuously an official

	because applicable law excuses performance to an assignee of the debtor (personal services contracts). 11 U.S.C. § 365. Contracts must be in writing only if they fall within the statute of frauds. Thus, some oral contracts are enforceable.	the contract will promote the orderly administration of the CFC's affairs. § 210(c)(1). The FDIC has a "reasonable" time from the date of its appointment as receiver to exercise such right. § 210(c)(2). Subsection 210(c) must not apply with respect to extensions of credit from any Federal Reserve Bank or the FDIC to any CFC or to any security interest in the assets of the CFC securing such extension of credit. § 210(c)(14). Contractual clauses which negatively affect a party's ability to acquire all or part of any CFC in a transaction in which the FDIC exercises its powers are against public policy and must be unenforceable. § 210(p).	record of the depository institution. 12 U.S.C. § 1823(e) (codifies the *D'Oench Duhme* case standards). The FDIC may repudiate any contract executed before the appointment of the FDIC where contract performance is "burdensome" and the repudiation of the contract will promote the orderly administration of the company's affairs. 12 U.S.C. § 1821(e)(1). This <u>must</u> not apply with respect to extensions of credit from any Federal Reserve Bank and federal home loan banks to any insured depositary institution or any security interest in the assets of the institution securing such extension of credit. § 1821(e)(14).
Damages for repudiation	If the contract is rejected, it will give rise to a pre-petition unsecured claim for damages, which may be paid *pro rata* rather than in full. Rejection claims for some types of contracts, such as long-term leases and employment contracts, are limited to defined time periods. Executory contracts first assumed by a debtor but subsequently rejected give rise to an administrative claim for a portion of the damages. Administrative claims must be paid in full by the debtor on or before the effective date of the plan. 11 U.S.C. § 503.	Damages for contracts executed or approved by the FDIC after its appointment as receiver must be paid as an administrative expense. § 210(a)(15). Damages for repudiation of a contract are limited to actual, direct compensatory damages, determined at the date of the appointment of the FDIC or the date of repudiation in the case of QFCs. § 210(c)(3)(A). There is no liability for other damages, including punitive, lost profits, pain and suffering and, presumably, attorney's fees. § 210(c)(3)(B). Compensatory damages for repudiated QFCs must include normal and reasonable costs of cover or other reasonable measures of damages used in the industry. § 210(c)(3)(C). For any debt for borrowed money or evidenced by a security, actual direct compensatory damages must be no less than the amount loaned plus accrued interest and any accreted original issue discount as of the date the FDIC was appointed receiver and, to the extent that an allowed secured claim is secured by property (the value of which is greater than the amount of such claim), any accrued interest through the date of repudiation or disaffirmance. § 210(c)(3)(D). For any contingent obligation of a CFC, consisting of	Damages for repudiation of a contract are limited to direct compensatory damages, determined at the date of the appointment of the FDIC. 12 U.S.C. § 1821(e)(3)(A)(i). But courts have determined that the amount of receiver liability can be affected by post-insolvency events. There is no liability for other damages, including punitive, lost profits and pain and suffering. 12 U.S.C. § 1821(e)(3)(B). Courts have construed this to mean that there is no liability for attorney's fees. Claimant under a contract repudiated by the FDIC must prove its damages to obtain compensation.

		any obligation under a guarantee, letter of credit, loan commitment or similar credit obligation, the FDIC may, by rule or regulation, prescribe that actual direct compensatory damages must be no less than the estimated value of the claim as of the date the FDIC was appointed receiver of the CFC. § 210(c)(3)(E).	
Contract enforcement	The DIP/trustee is the successor to the debtor's interest in any contracts and may enforce such interest. Before assumption or rejection, the non-debtor party to the agreement has to perform the agreement, and the DIP/trustee is generally obligated to timely perform the debtor's current obligations. Generally, termination provisions effective on the filing of a case under the Bankruptcy Code or in the event of insolvency are not enforceable; an exception exists for such termination provisions in the context of QFCs, financial accommodations contracts or contracts where applicable law excuses performance to an assignee of the debtor (personal services contracts).	The FDIC, as receiver, may enforce any contract, other than a director's or officer's liability insurance contract or financial institution bond. § 210(c)(13)(A). For the first 90 days of a receivership, the other party to a contract with a CFC may not exercise any right to terminate, accelerate or declare a default to the contract or obtain possession or control over any property of the CFC without the FDIC's consent. § 210(c)(13)(C)(i). This provision does not apply to director or officer liability insurance contracts, financial institution bonds, the rights of parties to certain QFCs or certain contracts under the FDIC Improvement Act. § 210(c)(13)(C)(ii). The FDIC, as receiver of a CFC or subsidiary of a CFC, must have the power to enforce contracts of subsidiaries or affiliates of the CFC for whom the obligations are guaranteed by the CFC, notwithstanding any *ipso facto* provision, provided that (i) such guaranty and all related assets and liabilities are transferred to and assumed by a Bridge Company or a third party or (ii) the FDIC provides adequate protection with respect to such obligations. § 210(c)(16)(A).	The FDIC as conservator or receiver may enforce any contract, other than a director's or officer's liability insurance contract or financial institution bond. 12 U.S.C. § 1821(e)(13)(A). For the first 45 days of a conservatorship and the first 90 days of a receivership, the other party to the contract may not exercise any right to terminate, accelerate, or declare a default to the contract without the FDIC's consent. 12 U.S.C. § 1821(e)(13)(C). Director or officer liability insurance contracts, financial institution bonds, certain qualified financial contracts, or certain contracts under the FDIC Improvement Act are exceptions. After the 45- or 90-day stay, a counterparty may exercise any such rights.
Service contracts	No separate provision. Treated as any other executory contract. See above. Generally, though, services performed after the petition date will be paid as an administrative expense. The contract can be rejected even if performance has been accepted prior to such rejection.	Service contracts for performances before the FDIC's appointment are treated as claims and deemed to have arisen on the date of the FDIC's appointment. § 210(c)(7)(A). Services accepted by the FDIC and performed after the FDIC's appointment must be paid as per the contract, which must be treated as an administrative expense. § 210(c)(7)(B). Service contracts can be repudiated despite acceptance or performance of the contract.	Service contracts for performances before the FDIC appointment are treated as claims and deemed to have arisen on the date of the FDIC appointment. 12 U.S.C. § 1821(e)(7)(A). Services accepted by the FDIC and performed after the FDIC appointment <u>must</u> be paid as per the contract, which <u>must</u> be treated as an administrative expense. 12 U.S.C. § 1821(e)(7)(B). Service contracts can be repudiated despite

		§ 210(c)(7)(C). The provisions of the Act are substantially similar to those of the FDIA.	acceptance or performance of the contract. 12 U.S.C. § 1821(e)(7)(C).
Property contracts	The DIP/trustee may assume, reject or assume and assign to a third party the debtor's interest in any pre-petition unexpired lease, subject to the obligation to cure any defaults, compensate for damages and provide adequate assurance of future performance. 11 U.S.C. § 365. Rejection damages claims under long-term leases are limited. The Bankruptcy Code contains complex provisions related to the rejection of license agreements, land contracts and the like, and the rights of the counterparties thereto.	Leases in which the FDIC is the lessee can be repudiated and the counterparty only has a claim for accrued rent. § 210(c)(4). Leases in which the FDIC is the lessor may be repudiated and the counterparty can treat the lease as terminated or remain in possession of the property, while continuing to pay rent. § 210(c)(5). Assignment and sale of land contracts by the FDIC are allowed. § 210(c)(6)(C). The Act contains various provisions concerning the payment of rent, purchasers and lessees that remain in possession, contracts for the sale of real property and leases under which the CFC is a lessor. § 210(c)(4)-(6). The provisions of the Act are substantially similar to those of the FDIA.	Leases can be repudiated but the counterparty cannot assert a claim for lost profits. 12 U.S.C. § 1821(e). Assignment and sale of land contracts are allowed. 12 U.S.C. § 1821(e)(6)(C).
Qualified Financial Contracts ("QFCs")	The Bankruptcy Code provides "safe harbors" for Qualified Financial Contracts, which are defined as securities contracts, forward contracts, commodity contracts, repurchase agreements, swap agreements and other similar agreements. Credit support, including guarantees, issued in connection with these QFCs is also protected. Non-debtor counterparties may, immediately and without seeking relief from the automatic stay, exercise their contractual rights under Qualified Financial Contracts to (i) terminate or accelerate the obligations of the parties and liquidate and realize against any collateral held to secure the debtor's obligations, and (ii) set off mutual debts and claims. These rights would typically be restricted under the Bankruptcy Code, in order to protect the estate of the debtor. In	QFCs are securities contracts, commodities contracts, forward contracts, repurchase agreements, swap agreements or other similar agreements that the FDIC determines by regulation, resolution or order to be QFCs. § 210(c)(8)(D)(i). After the FDIC is appointed as receiver, the non-CFC counterparty to a QFC must wait until 5:00 p.m. of the following business day of the appointment of the receiver or after the person received notice that the contract has been transferred, to exercise any right to terminate, liquidate or net such contract solely because of the FDIC's appointment as receiver or for the insolvency or financial condition of the CFC. § 210(c)(10)(B)(i). During this time, the FDIC may choose to transfer all of the QFCs and related claims of a QFC to one financial institution for which a conservator, receiver, trustee or other legal custodian has not been appointed, including a Bridge Company, or none of the QFCs and related claims. §§ 210(c)(9)(A) and (10)(C). After such transfer, the	Qualified Financial Contracts are securities contracts, commodities contracts, forward contracts, repurchase agreements, swap agreements or other similar agreements. 12 U.S.C. § 1821(e)(8)(D)(i). If the FDIC is appointed as the receiver, parties to QFCs can terminate, liquidate, or accelerate the contract; exercise any right under a security agreement related to the contract; or exercise any right to a transfer obligation with one or more such contracts that is related to the termination, liquidation or acceleration of a qualified financial contract. 12 U.S.C. § 1821(e)(8)(A)(i). The party must wait until 5:00 p.m. the following business day of the appointment of the receiver to exercise any right to terminate, liquidate or net such contract solely because of the FDIC's appointment as receiver.

	addition, any deliveries or settlements made pursuant to these Qualified Financial Contracts are protected from being avoided as either preferential or fraudulent transfers, provided that they were not made with an intent to defraud.	counterparty cannot terminate the QFC based on the transfer or the appointment of the FDIC. § 210(c)(10)(B)(i). After the waiting period has elapsed, and the QFCs have not been transferred to another financial institution (as set forth above), the counterparties may then exercise their rights to terminate, liquidate or accelerate the contract; exercise any rights under a related security agreement; or exercise its rights to offset or net amounts due in connection with such QFCs. § 210(c)(10)(B)(i). The FDIC may not avoid a transfer of money or property in connection with any QFC with a CFC, unless the transferee had actual intent to hinder, delay or defraud the CFC, its creditors or the receiver for the CFC. § 210(c)(8)(C). The FDIC, as receiver, must choose to repudiate all QFCs between the company and any person, or affiliate of that person, or disaffirm none of those QFCs. § 210(c)(11). This provision is to ensure that the FDIC is not "cherry-picking" only those QFCs in its favor. When transferring QFCs, the FDIC can transfer all QFCs, claims and property securing the QFC or other credit enhancement between any person or affiliate and the CFC, or transfer none of the QFCs, claims, property or credit enhancements. § 210(c)(9)(A). Clauses that suspend conditions, or extinguish a payment obligation of a party due to a party's status as a non-defaulting party ("walk away clauses") are unenforceable in a QFC of a CFC in default. § 210(c)(8)(F). For any QFC subject to or cleared by a clearing organization, the FDIC must use its best efforts to meet all margin, collateral and settlement obligations of the CFC that arise under the QFC. If the FDIC defaults, the clearing organization must have the immediate right to exercise all of its rights and remedies under its rules and applicable law. § 210(c)(8)(G). Within 24 months of enactment of this Act, the	During this time, the FDIC may choose to transfer the QFCs to a third party, at which time the counterparty cannot terminate the QFC based on the transfer or the appointment of the FDIC. 12 U.S.C. § 1821(e)(10)(B)(i). If the FDIC is appointed as the conservator, a party to a QFC may not terminate, liquidate or net such contract solely by reason of the appointment of a conservator for the institution or the insolvency or financial condition of the institution for which the conservator has been appointed. 12 U.S.C. § 1821(e)(10)(B)(ii). The FDIC may not avoid a transfer of money or property in connection with any QFC with a CFC, unless the transferee had actual intent to hinder, delay or defraud such institution, the creditors of such institution, or any conservator or receiver appointed for such institution. 12 U.S.C. § 1821 (e)(8)(C)(ii). The FDIC, as conservator or receiver, must choose to repudiate all QFCs between the institution and any person, or affiliate of that person, or disqualify none of those QFCs. 12 U.S.C. § 1821(e)(11). The FDIC, as conservator or receiver, can transfer all QFCs, claims and property securing the credit between the company and a party, or none of the QFCs. The FDIC cannot transfer these assets or liabilities to a company in bankruptcy or that has a conservator or receiver. 12 U.S.C. § 1821(e)(9). Damages for repudiation are determined as of the date of the repudiation of the contract and include the cost of cover. Clauses that suspend conditions, or extinguish a payment obligation of a party due to a party's status as a non-defaulting party ("walk away clauses") are unenforceable in qualified financial contracts. 12 U.S.C.

		federal primary financial regulatory agencies must jointly prescribe regulations requiring that financial companies maintain records with respect to QFCs in order to assist the FDIC in implementing its duties in regards to the transfer, and notification of transfer, of a QFC. § 210(c)(8)(H). The provisions of the Act are substantially similar to those of the FDIA.	§ 1821(e)(8)(G).
***Ipso facto* clause**	To protect the debtor's estate, provisions allowing a counterparty to terminate a contract or a lease with the debtor because the debtor is insolvent or has filed for bankruptcy will generally not be enforced. 11 U.S.C. § 365(e). There are exceptions, however, including QFCs, personal services contracts and contracts for financing accommodations.	The FDIC, as receiver, may enforce any contract, other than a director's or officer's liability insurance contract or financial institution bond, notwithstanding any provision that would otherwise allow counterparties to terminate, default, accelerate or exercise any other rights upon, or solely because of, the insolvency of the CFC, the Secretary's determination and petition of the Court or appointment of the FDIC as receiver. As such, *ipso facto* clauses are not enforceable at the counterparty's discretion. There are no exceptions for personal services contracts, IP licenses or financing contracts. § 210(c)(13)(A). The provisions of the Act are substantially similar to those of the FDIA.	Conservator or receiver may enforce any contract, other than a director's or officer's liability insurance contract or financial institution bond, notwithstanding any provision that would otherwise allow counterparties to terminate, treat as a default, accelerate or exercise any other rights upon, or solely because of, the insolvency or appointment of the FDIC as conservator or receiver. 12 U.S.C. § 1821(e)(12)(A). Thus, *ipso facto* clauses are not enforceable at the counterparty's discretion. The FDIC may choose to enforce the contract irrespective of any *ipso facto* clause. *Ipso facto* clauses create a provable claim for damages at the time of repudiation because the status of the parties was permanently fixed at the time of default. The counterparty can seek to file a claim for the contract.
Confidentiality agreements	Generally, actions taken and decisions made in a bankruptcy case must be disclosed and are publicly available. Under certain circumstances, the Bankruptcy Court may enter an order protecting the disclosure of proprietary and trade secret information.	The FDIC may not enter into any agreement or approve any protective order which prohibits the FDIC from disclosing the terms of a settlement of an administrative or other action from damages or restitution brought by the FDIC as receiver. § 210(l). The provisions of the Act are substantially similar to those of the FDIA.	The FDIC may not enter into any agreement or any protective order which prohibits the FDIC from disclosing the terms of a settlement brought by the FDIC as conservator or receiver. 12 U.S.C. § 1821(s).
Bridge Bank Holding Company ("Bridge Companies")	No concept of Bridge Companies to hold assets, although often a plan of reorganization will distribute certain assets to a liquidating trust, which will liquidate those assets and distribute them as provided	Bridge Companies may assume liabilities, purchase assets and perform other temporary functions of the FDIC. § 210(h)(1)(B). The FDIC, as receiver, may transfer any of the CFC's	The FDIC can create "bridge banks." 12 U.S.C. § 1821(d)(2)(F)(ii). The Office of the Comptroller of the Currency provides national charters for bridge banks.

	in the plan. Generally, a liquidating trust only holds non-operating assets and litigation claims, but not the operating assets of a business.	assets and liabilities to one or more Bridge Companies. § 210(h)(5)(A). The Bridge Company will work to maximize the net asset value of the transferred assets and liabilities. The company left behind would be liquidated. The FDIC can create Bridge Companies with federal charters except where the CFC is a CBD. § 210(h)(2)(A). The FDIC appoints the board of directors of the Bridge Company. § 210(h)(2)(B). A Bridge Company must assume, acquire, or succeed to the assets or liabilities of the CFC to the extent the CFC's assets or liabilities are transferred to the Bridge Company, but the Bridge Company must not assume obligations stemming from an equity interest in the CFC. § 210(h)(3). The aggregate amount of liabilities of a CFC that are transferred to the Bridge Company may not exceed the aggregate amount of assets of the CFC that are transferred to, or purchased by, the Bridge Company from the CFC. § 210(h)(5)(F). The FDIC may provide funding to facilitate a transaction of or acquisition by a Bridge Company. § 210(h)(9). A Bridge Company will be treated as a CFC in default at such times and for such purposes as the FDIC may determine. § 210(h)(4). The Bridge Company can operate without any capital or surplus. The Bridge Company can also issue capital stock and securities. § 210(h)(2)(G). The FDIC must treat all similarly situated creditors of a Bridge Company in a similar manner in transferring any assets or liabilities of the CFC to a Bridge Company. § 210(h)(5)(E). The FDIC does not have to comply with § 210(h)(5)(E) if (i) the FDIC determines that such actions are necessary to maximize the value of the assets of the CFC, maximize the present value of return from the sale of assets, minimize the amount of any loss from the sale of assets or to contain or address serious adverse	12 U.S.C. § 1821(n)(1)(A). A bridge bank does not have federal status. 12 U.S.C. § 1821(n)(6). Bridge banks may assume defaulting deposits, assume other liabilities, purchase assets and perform other temporary functions of the institution. 12 U.S.C. § 1821(n)(1)(B). The FDIC appoints the board of directors of the bridge bank. 12 U.S.C. § 1821(n)(2)(D). The FDIC-controlled institution can transfer any assets and liabilities of the institution to the bridge bank. 12 U.S.C. § 1821(n)(3)(A). The FDIC does not have to give the bridge bank any capital to operate. The FDIC can make available to the bridge bank funds for its operation. 12 U.S.C. § 1821(n)(5).

		effects to financial stability; and (ii) all similarly situated creditors receive not less than the Liquidation Amount. § 210(h)(5)(E). Bridge Companies can obtain unsecured credit and issue unsecured debt. § 210(h)(16)(A). If a Bridge Company is unable to obtain unsecured credit or issue unsecured debt, the FDIC may authorize it to obtain secured credit or issue debt with priority over any or all obligations of the Bridge Company, secured by a lien on property that is not otherwise subject to a lien or secured by a junior lien. § 210(h)(16)(B). The FDIC may, after notice and a hearing, authorize the Bridge Company to obtain debt secured by a senior or equal lien on property of the Bridge Company if the Bridge Company is unable to otherwise obtain such credit and there is adequate protection of the interest of the holder of the lien on the property the senior or equal lien is proposed to be granted. § 210(h)(16)(C). No credit or debt obtained or issued by a Bridge Company may contain terms that impair the rights of a counterparty to a QFC upon a default by the Bridge Company, other than the priority of such counterparty's unsecured claim (after the exercise of rights) relative to the priority of the Bridge Company's obligations. § 210(h)(16)(E). 1. If the FDIC establishes one or more Bridge Companies with respect to a CBD, the FDIC must transfer all customer accounts of the CBD to the Bridge Company unless the FDIC, after consulting with the SEC and SIPC, determines that the customer accounts are likely to be promptly transferred to another CBD, or the transfer of the accounts to a Bridge Company would materially interfere with the FDIC's ability to avoid or mitigate serious adverse effects on financial stability of the U.S. § 210(a)(1)(O). 2. The FDIC, as receiver for a CBD, may approve articles of association for one or more Bridge Companies that are covered brokers or dealers, which must (i) be established and deemed registered with	

		the SEC and a member of the SIPC; (ii) operate in accordance with such articles and § 210; and (iii) succeed to any and all registrations and memberships of the CFC with any self-regulatory organizations. § 210(h)(2)(H)(i). Customer accounts of CBDs transferred to a Bridge Company must have the same protections under § 205(f) and the SIPA, and the FDIC must not operate the Bridge Company in such a way so as to limit the ability of customers to access customer property. § 210(h)(2)(H)(iii) and (iv). Generally, a Bridge Company terminates 2 years after the charter was granted but the FDIC may extend this for three additional 1-year periods. § 210(h)(12).	

Appendix B

Selected U.S. Senate and House of Representatives Colloquies

Senator Collins - Nonbank Financial Companies

Ms. COLLINS. Mr. President, as we move to final passage of this historic legislation, I would like to thank Senator Dodd again for his leadership and strong support for my amendment to ensure that all insured depository institutions and depository institution holding companies regardless of size, as well as nonbank financial companies supervised by the Federal Reserve, meet statutory minimum capital standards and thus have adequate capital throughout the economic cycle. Those standards required under Section 171 serve as the starting point for the development of more stringent standards as required under Section 165 of the Act.

I did, however, have questions about the designation of certain nonbank financial companies under section 113 for Federal Reserve supervision and the significance of such a designation in light of the minimum capital standards established by Section 171. While I can envision circumstances where a company engaged in the business of insurance could be designated under section 113, I would not ordinarily expect insurance companies engaged in traditional insurance company activities to be designated by the council based on those activities alone. Rather, in considering a designation, I would expect the council to specifically take into account, among other risk factors, how the nature of insurance differs from that of other financial products, including how traditional insurance products differ from various off-balance-sheet and derivative contract exposures and how that different nature is reflected in the structure of traditional insurance companies. I would also expect the council to consider whether the designation of an insurance company is appropriate given the existence of State-based guaranty funds to pay claims and protect policyholders. Am I correct in that understanding?

Mr. DODD. The Senator is correct. The council must consider a number of factors, including, for example, the extent of leverage, the extent and nature of off-balance-sheet exposures, and the nature, scope, size, scale, concentration, interconnectedness, and mix of the company's activities. Where a company is engaged only in traditional insurance activities, the council should also take into account the matters you raised.

Ms. COLLINS. Would the Senator agree that the council should not base designations simply on the size of the financial companies?

Mr. DODD. Yes. The size of a financial company should not by itself be determinative.

Ms. COLLINS. As the Senator knows, insurance companies are already heavily regulated by State regulators who impose their own, very different regulatory and capital requirements. The fact that those capital requirements are not the same as those imposed by section 171 should not increase the likelihood that the council will designate an insurer. Does the Senator agree?

Mr. DODD. Yes, I do not believe that the council should decide to designate an insurer simply based on whether the insurer would meet bank capital requirements.

Senator Collins and Senator Shaheen - Capital Requirements

CAPITAL REQUIREMENTS

Ms. COLLINS. Mr. President, I understand that it is the intent of paragraph 7 of section 171(b) of this legislation to require the Federal banking agencies, subject to the recommendations of the council, to develop capital requirements applicable to insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Board of Governors that are engaged in activities that are subject to heightened standards under section 120. It is well understood that minimum capital requirements can help to shield various public and private stakeholders from risks posed by material distress that could arise at these entities from engaging in these activities. It is also understood and recognized that minimum capital requirements may not be an appropriate tool to apply under all circumstances and that by prescribing section 171 capital requirements as the correct tool with respect to companies covered by paragraph 7, it should not be inferred that capital requirements should be required for any other companies not covered by paragraph 7.

Mrs. SHAHEEN. I also understand that the intent of this section is not to create any inference that minimum capital requirements are the appropriate standard or safeguard for the council to recommend to be applied to any nonbank financial company that is not subject to supervision by the Federal Reserve under title I of this legislation, with respect to any activity subject to section 120. Rather, the council should have full discretion not to recommend the application of capital requirements to any such nonbank financial company engaged in any such activity.

Mr. DODD. I concur with Senator Collins and Senator Shaheen. Section 171 of this legislation came from an amendment that Senator Collins offered on the Senate floor, and I truly appreciate the constructive contribution she has made to this legislative process. My understanding also is that the capital requirements under paragraph 7 are intended to apply only to insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Board of Governors. I thank my friends from Maine and New Hampshire for this clarification.

Senator Kerry – Non-Bank Financial Companies

Mr. KERRY. Mr. President, the conference report to accompany H.R. 4173, the Dodd-Frank Wall Street reform bill, creates a mechanism through which the Financial Stability Oversight Council may determine that material financial distress at a U.S. nonbank financial company could pose such a threat to the financial stability of the United States that the company should be supervised by the Board of Governors of the Federal Reserve System and should be subject to heightened prudential standards. It is my understanding that in making such a determination, the Congress intends that the council should focus on risk factors that contributed to the recent financial crisis, such as the use of excessive leverage and major off-balance-sheet exposure. The fact that a company is large or is significantly involved in financial services does not mean that it poses significant risks to the financial stability of the United States. There are large companies providing financial services that are in fact traditionally low-risk businesses, such as mutual funds and mutual fund advisers. We do not envision nonbank financial companies that pose little risk to the stability of the financial system to be supervised by the Federal Reserve. Does the chairman of the Banking Committee share my understanding of this provision?

Mr. DODD. The Senator from Massachusetts is correct. Size and involvement in providing credit or liquidity alone should not be determining factors. The Banking Committee intends that only a limited number of high-risk, nonbank financial companies would join large bank holding companies in being regulated and supervised by the Federal Reserve.

Senator Kohl - Assessments

ASSESSING INDIVIDUAL ENTITIES

Mr. KOHL. Mr. President, I thank the Chairman for his continued work to ensure that appropriate resources are available to protect the economy from a future failure of a systemically risky financial institution and to help pay back taxpayers for the recent failures we experienced.

With regard to assessments under the orderly liquidation authority of the bill, the bill requires that a risk-based matrix of factors be established by the FDIC, taking into account the recommendations of the Financial Stability Oversight Council, to be used in connection with assessing any individual entity. One of the factors listed in the bill's risk matrix provision would take into account the activities of financial entities and their affiliates. Is it the intent of that language that a consideration of such factors should specifically include the impact of potential assessments on the ability of an institution that is a tax-exempt, not-for-profit organization to carry out their legally required charitable and educational activities?

As the Senator knows, many Members of the Senate—like me—feel strongly that we must ensure that our constituents and communities continue to have access to these vital resources, and any potential assessment on tax-exempt groups which are charitable and/or educational by mission could severely hamper these groups' ability to fulfill their obligations to carry out their legally required activities.

Mr. DODD. Yes, that is correct. The language is not intended to reduce such charitable and educational activities that are legally required for tax-exempt, not-for-profit organizations that are so important to communities across the country. I thank the Senator for his continued help on these efforts.

Senators Merkley and Levin – The Volcker Rule (I)

Mr. LEVIN. Mr. President, Senator Merkley and I, as the principal authors of sections 619, 620, and 621 of the Dodd-Frank Act, thought it might be helpful to explain in some detail those sections, which are based on our bill, S. 3098, called the Protect Our Recovery Through Oversight of Proprietary, PROP, Trading Act of 2010, and the subsequently filed Merkley-Levin Amendment, No. 4101, to the Dodd-Lincoln substitute, which was the basis of the provision adopted by the Conference Committee.

I yield the floor to my colleague, Senator MERKLEY.

Mr. MERKLEY. I thank Senator LEVIN and will be setting forth here our joint explanation of the Merkley-Levin provisions of the Dodd-Frank Act. Sections 619, 620 and 621 do three things: prohibit high-risk proprietary trading at banks, limit the systemic risk of such activities at systemically significant nonbank financial companies, and prohibit material conflicts of interest in asset-backed securitizations.

Sections 619 and 620 amend the Bank Holding Company Act of 1956 to broadly prohibit proprietary trading, while nevertheless permitting certain activities that may technically fall within the definition of proprietary trading but which are, in fact, safer, client-oriented financial services. To account for the additional risk of proprietary trading among systemically critical financial firms that are not banks, bank holding companies, or the like, the sections require nonbank financial companies supervised by the Federal Reserve Board, the "Board", to keep additional capital for their proprietary trading activities and subject them to quantitative limits on those activities. In addition, given the unique control that firms who package and sell asset-backed securities (including synthetic asset-backed securities) have over transactions involving those securities, section 621 protects purchasers by prohibiting those firms from engaging in transactions that involve or result in material conflicts of interest.

First, it is important to remind our colleagues how the financial crisis of the past several years came to pass. Beginning in the 1980's, new financial products and significant amounts of deregulation undermined the Glass-Steagall Act's separation of commercial banking from securities brokerage or "investment banking" that had kept our banking system relatively safe since 1933.

Over time, commercial and investment banks increasingly relied on precarious short term funding sources, while at the same time significantly increasing their leverage. It was as if our banks and securities firms, in competing against one another, were race car drivers taking the curves ever more tightly and at ever faster speeds. Meanwhile, to match their short-term funding sources, commercial and investment banks drove into increasingly risky, short-term, and sometimes theoretically hedged, proprietary trading. When markets took unexpected turns, such as when Russia defaulted on its debt and when the U.S. mortgage-backed securities market collapsed, liquidity evaporated, and financial firms became insolvent very rapidly. No amount of capital could provide a sufficient buffer in such situations.

In the face of the worst financial crisis in 60 years, the January 2009 report by the Group of 30, an international group of financial experts, placed blame squarely on proprietary trading.

This report, largely authored by former Federal Reserve System Chairman Paul Volcker, recommended prohibiting systemically critical banking institutions from trading in securities and other products for their own accounts. In January 2010, President Barack Obama gave his full support to common-sense restrictions on proprietary trading and fund investing, which he coined the "Volcker Rule."

The "Volcker Rule," which Senator Levin and I drafted and have championed in the Senate, and which is embodied in section 619, embraces the spirit of the Glass-Steagall Act's separation of "commercial" from "investment" banking by restoring a protective barrier around our critical financial infrastructure. It covers not simply securities, but also derivatives and other financial products. It applies not only to banks, but also to nonbank financial firms whose size and function render them systemically significant.

While the intent of section 619 is to restore the purpose of the Glass-Steagall barrier between commercial and investment banks, we also update that barrier to reflect the modern financial world and permit a broad array of low-risk, client-oriented financial services. As a result, the barrier constructed in section 619 will not restrict most financial firms.

Section 619 is intended to limit proprietary trading by banking entities and systemically significant nonbank financial companies. Properly implemented, section 619's limits will tamp down on the risk to the system arising from firms competing to obtain greater and greater returns by increasing the size, leverage, and riskiness of their trades. This is a critical part of ending too big to fail financial firms. In addition, section 619 seeks to reorient the U.S. banking system away from leveraged, short-term speculation and instead towards the safe and sound provision of long-term credit to families and business enterprises.

We recognize that regulators are essential partners in the legislative process. Because regulatory interpretation is so critical to the success of the rule, we will now set forth, as the principal authors of Sections 619 to 621, our explanations of how these provisions work.

Section 619's prohibitions and restrictions on proprietary trading are set forth in a new section 13 to the Bank Holding Company Act of 1956, and subsection (a), paragraph (1) establishes the basic principle clearly: a banking entity shall not "engage in proprietary trading" or "acquire or retain . . . ownership interest[s] in or sponsor a hedge fund or private equity fund", unless otherwise provided in the section. Paragraph (2) establishes the principle for nonbank financial companies supervised by the Board by subjecting their proprietary trading activities to quantitative restrictions and additional capital charges. Such quantitative limits and capital charges are to be set by the regulators to address risks similar to those which lead to the flat prohibition for banking entities.

Subsection (h), paragraph (1) defines "banking entity" to be any insured depository institution (as otherwise defined under the Bank Holding Company Act), any entity that controls an insured depository institution, any entity that is treated as a bank holding company under section 8 of the International Banking Act of 1978, and any affiliates or subsidiaries of such entities. We and the Congress specifically rejected proposals to exclude the affiliates and subsidiaries of bank holding companies and insured depository institutions, because it was obvious that restricting a bank, but not its affiliates and subsidiaries, would ultimately be ineffective in restraining the type of high-risk proprietary trading that can undermine an insured depository institution.

The provision recognizes the modern reality that it is difficult to separate the fate of a bank and its bank holding company, and that for the bank holding company to be a source of strength to the bank, its activities, and those of its other subsidiaries and affiliates, cannot be at such great risk as to imperil the bank. We also note that not all banks pose the same risks. Accordingly, the paragraph provides a narrow exception for insured depository institutions that function principally for trust purposes and do not hold public depositor money, make loans, or access Federal Reserve lending or payment services. These specialized entities that offer very limited trust services are elsewhere carved out of the definition of "bank," so we do not treat them as banks for the purposes of the restriction on proprietary trading. However, such institutions are covered by the restriction if they qualify under the provisions covering systemically important nonbank financial companies.

Subsection (h), paragraph (3) defines nonbank financial companies supervised by the Board to be those financial companies whose size, interconnectedness, or core functions are of sufficiently systemic significance as to warrant additional supervision, as directed by the Financial Stability Oversight Council pursuant to Title I of the Dodd-Frank Act. Given the varied nature of such nonbank financial companies, for some of which proprietary trading is effectively their business, an outright statutory prohibition on such trading was not warranted. Instead, the risks posed by their proprietary trading is addressed through robust capital charges and quantitative limits that increase with the size, interconnectedness, and systemic importance of the business functions of the nonbank financial firm. These restrictions should become stricter as size, leverage, and other factors increase. As with banking entities, these restrictions should also help reduce the size and risk of these financial firms.

Naturally, the definition of "proprietary trading" is critical to the provision. For the purposes of section 13, proprietary trading means "engaging as a principal for the trading account" in transactions to "purchase or sell, or otherwise acquire or dispose of" a wide range of traded financial products, including securities, derivatives, futures, and options. There are essentially three key elements to the definition: (1) the firm must be acting "as a principal," (2) the trading must be in its "trading account" or another similar account, and (3) the restrictions apply to the full range of its financial instruments.

Purchasing or selling "as a principal" refers to when the firm purchases or sells the relevant financial instrument for its own account. The prohibition on proprietary trading does not cover trading engaged with exclusively client funds.

The term "trading account" is intended to cover an account used by a firm to make profits from relatively short-term trading positions, as opposed to long-term, multi-year investments. The administration's proposed Volcker Rule focused on short-term trading, using the phrase "trading book" to capture that concept. That phrase, which is currently used by some bank regulators was rejected, however, and the ultimate conference report language uses the term "trading account" rather than "trading book" to ensure that all types of accounts used for proprietary trading are covered by the section.

To ensure broad coverage of the prohibition on proprietary trading, paragraph (3) of subsection (h) defines "trading account" as any account used "principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements)" and such other accounts as the regulators determine are properly covered by the provision to fulfill the purposes of the section. In designing this definition, we were aware of bank regulatory capital rules that distinguish between short-term trading and long-term investments, and our overall focus was to restrict high-risk proprietary trading. For banking entity subsidiaries that do not maintain a distinction between a trading account and an investment account, all accounts should be presumed to be trading accounts and covered by the restriction.

Linking the prohibition on proprietary trading to trading accounts permits banking entities to hold debt securities and other financial instruments in long-term investment portfolios. Such investments should be maintained with the appropriate capital charges and held for longer periods.

The definition of proprietary trading in paragraph (4) covers a wide range of financial instruments, including securities, commodities, futures, options, derivatives, and any similar financial instruments. Pursuant to the rule of construction in subsection (g), paragraph (2), the definition should not generally include loans sold in the process of securitizing; however, it could include such loans if such loans become financial instruments traded to capture the change in their market value.

Limiting the definition of proprietary trading to near-term holdings has the advantage of permitting banking entities to continue to deploy credit via long-term capital market debt instruments. However, it has the disadvantage of failing to prevent the problems created by longer-term holdings in riskier financial instruments, for example, highly complex collateralized debt obligations and other opaque instruments that are not readily marketable. To address the risks to the banking system arising from those longer-term instruments and related trading, section 620 directs Federal banking regulators to sift through the assets, trading strategies, and other investments of banking entities to identify assets or activities that pose unacceptable risks to banks, even when held in longer-term accounts. Regulators are expected to apply the lessons of that analysis to tighten the range of investments and activities permissible for banking entities, whether they are at the insured depository institution or at an affiliate or subsidiary, and whether they are short or long term in nature.

The new Bank Holding Company Act section 13 also restricts investing in or sponsoring hedge funds and private equity funds. Clearly, if a financial firm were able to structure its proprietary positions simply as an investment in a hedge fund or private equity fund, the prohibition on proprietary trading would be easily avoided, and the risks to the firm and its subsidiaries and affiliates would continue. A financial institution that sponsors or manages a hedge fund or private equity fund also incurs significant risk even when it does not invest in the fund it manages or sponsors. Although piercing the corporate veil between a fund and its sponsoring entity may be difficult, recent history demonstrates that a financial firm will often feel compelled by reputational demands and relationship preservation concerns to bail out clients in a failed fund that it managed or sponsored, rather than risk litigation or lost business. Knowledge of such concerns creates a moral hazard among clients, attracting investment into managed or sponsored funds on the assumption that the sponsoring bank or systemically significant firm will rescue them if markets turn south, as was done by a number of firms during the 2008 crisis. That is why setting limits on involvement in hedge funds and private equity funds is critical to protecting against risks arising from asset management services.

Subsection (h), paragraph (2) sets forth a broad definition of hedge fund and private equity fund, not distinguishing between the two. The definition includes any company that would be an investment company under the Investment Company Act of 1940, but is excluded from such coverage by the provisions of sections 3(c)(1) or 3(c)(7). Although market practice in many cases distinguishes between hedge funds, which tend to be trading vehicles, and private equity funds, which tend to own entire companies, both types of funds can engage in high risk activities and it is exceedingly difficult to limit those risks by focusing on only one type of entity.

Despite the broad prohibition on proprietary trading set forth in subsection (a), the legislation recognizes that there are a number of low-risk proprietary activities that do not pose unreasonable risks and explicitly permits those activities to occur. Those low-risk proprietary trading activities are identified in subsection (d), paragraph (1), subject to certain limitations set forth in paragraph (2), and additional capital charges required in paragraph (3).

While paragraph (1) authorizes several permitted activities, it simultaneously grants regulators broad authority to set further restrictions on any of those activities and to supplement the additional capital charges provided for by paragraph (3).

Subparagraph (d)(1)(A) authorizes the purchase or sale of government obligations, including government-sponsored enterprise, GSE, obligations, on the grounds that such products are used as low-risk, short-term liquidity positions and as low-risk collateral in a wide range of transactions, and so are appropriately retained in a trading account. Allowing trading in a broad range of GSE obligations is also meant to recognize a market reality that removing the use of these securities as liquidity and collateral positions would have significant market implications, including negative implications for the housing and farm credit markets. By authorizing trading in GSE obligations, the language is not meant to imply a view as to GSE operations or structure over the long-term, and permits regulators to add restrictions on this permitted activity as necessary to prevent high-risk proprietary trading activities under paragraph (2). When GSE reform occurs, we expect these provisions to be adjusted accordingly. Moreover, as is the case with all permitted activities under paragraph (1), regulators are expected to apply additional capital restrictions under paragraph (3) as necessary to account for the risks of the trading activities.

Subparagraph (d)(1)(B) permits underwriting and market-making-related transactions that are technically trading for the account of the firm but, in fact, facilitate the provision of near-term client-oriented financial services. Market-making is a customer service whereby a firm assists its customers by providing two-sided markets for speedy acquisition or disposition of certain financial instruments. Done properly, it is not a speculative enterprise, and revenues for the firm should largely arise from the provision of credit provided, and not from the capital gain earned on the change in the price of instruments held in the firm's accounts. Academic literature sets out the distinctions between making markets for customers and holding speculative positions in assets, but in general, the two types of trading are distinguishable by the volume of trading, the size of the positions, the length of time that positions remains open, and the volatility of profits and losses, among other factors. Regulations implementing this permitted activity should focus on these types of factors to assist regulators in distinguishing between financial firms assisting their clients versus those engaged in proprietary trading. Vigorous and robust regulatory oversight of this issue will be essential to prevent "market-making" from being used as a loophole in the ban on proprietary trading.

The administration's draft language, the original section 619 contemplated by the Senate Banking Committee, and amendment 4101 each included the term "in facilitation of customer relations" as a permitted activity. The term was removed in the final version of the Dodd-Frank Act out of concern that this phrase was too subjective, ambiguous, and susceptible to abuse. At the same time, we recognize that the term was previously included to permit certain legitimate client-oriented services, such pre-market-making accumulation of small positions that might not rise to the level of fully "market-making" in a security or financial instrument, but are intended to nonetheless meet expected near-term client liquidity needs. Accordingly, while previous versions of the legislation referenced "market-making", the final version references "market-making-related" to provide the regulators with limited additional flexibility to incorporate those types of transactions to meet client needs, without unduly warping the common understanding of market-making.

We note, however, that "market-making-related" is not a term whose definition is without limits. It does not implicitly cover every time a firm buys an existing financial instrument with the intent to later sell it, nor does it cover situations in which a firm creates or underwrites a new security with the intent to market it to a client. Testimony by Goldman Sachs Chairman Lloyd Blankfein and other Goldman executives during a hearing before the Permanent Subcommittee on Investigations seemed to suggest that any time the firm created a new mortgage related security and began soliciting clients to buy it, the firm was "making a market" for the security. But one-sided marketing or selling securities is not equivalent to providing a two-sided market for clients buying and selling existing securities. The reality was that Goldman Sachs was creating new securities for sale to clients and building large speculative positions in high-risk instruments, including credit default swaps. Such speculative activities are the essence of proprietary trading and cannot be properly considered within the coverage of the terms "market-making" or "market-making-related."

The subparagraph also specifically limits such underwriting and market-making-related activities to "reasonably expected near term demands of clients, customers, and counterparties." Essentially, the subparagraph creates two restrictions, one on the expected holding period and one on the intent of the holding. These two restrictions greatly limit the types of risks and returns for market-makers. Generally, the revenues for market-making by the covered firms should be made from the fees charged for providing a ready, two-sided market for financial instruments, and not from the changes in prices acquired and sold by the financial institution. The "near term" requirement connects to the provision in the definition of trading account whereby the account is defined as trading assets that are acquired "principally for the purpose of selling in the near term." The intent is to focus firms on genuinely making markets for clients, and not taking speculative positions with the firm's capital. Put simply, a firm will not satisfy this requirement by acquiring a position on the hope that the position will be able to be sold at some unknown future date for a trading profit.

Subparagraph (d)(1)(C) permits a banking entity to engage in "risk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings of the banking entity that are designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings." This activity is permitted because its sole purpose is to lower risk.

While this subparagraph is intended to permit banking entities to utilize their trading accounts to hedge, the phrase "in connection with and related to individual or aggregated positions ....." was added between amendment 4101 and the final version in the conference report in order to ensure that the hedge applied to specific, identifiable assets, whether it be on an individual or aggregate basis. Moreover, hedges must be to reduce "specific risks" to the banking entity arising from these positions. This formulation is meant to focus banking entities on traditional hedges and prevent proprietary speculation under the guise of general "hedging." For example, for a bank with a significant set of loans to a foreign country, a foreign exchange swap may be an appropriate hedging strategy. On the other hand, purchasing commodity futures to "hedge" inflation risks that may generally impact the banking entity may be nothing more than proprietary trading under another name. Distinguishing between true hedges and covert proprietary trades may be one of the more challenging areas for regulators, and will require clear identification by financial firms of the specific assets and risks being hedged, research and analysis of market best practices, and reasonable regulatory judgment calls. Vigorous and robust regulatory oversight of this issue will be essential to the prevent "hedging" from being used as a loophole in the ban on proprietary trading.

Subparagraph (d)(1)(D) permits the acquisition of the securities and other affected financial instruments "on behalf of customers." This permitted activity is intended to allow financial firms to use firm funds to purchase assets on behalf of their clients, rather than on behalf of themselves. This subparagraph is intended, in particular, to provide reassurance that trading in "street name" for customers or in trust for customers is permitted.

In general, subparagraph (d)(1)(E) provides exceptions to the prohibition on investing in hedge funds or private equity funds, if such investments advance a "public welfare" purpose. It permits investments in small business investment companies, which are a form of regulated venture capital fund in which banks have a long history of successful participation. The subparagraph also permits investments "of the type" permitted under the paragraph of the National Bank Act enabling banks to invest in a range of low-income community development and other projects. The subparagraph also specifically mentions tax credits for historical building rehabilitation administered by the National Park Service, but is flexible enough to permit the regulators to include other similar low-risk investments with a public welfare purpose.

Subparagraph (d)(1)(F) is meant to accommodate the normal business of insurance at regulated insurance companies that are affiliated with banks. The Volcker Rule was never meant to affect the ordinary business of insurance: the collection and investment of premiums, which are then used to satisfy claims of the insured. These activities, while definitionally proprietary trading, are heavily regulated by State insurance regulators, and in most cases do not pose the same level of risk as other proprietary trading.

However, to prevent abuse, firms seeking to rely on this insurance-related exception must meet two essential qualifications. First, only trading for the general account of the insurance firm would qualify. Second, the trading must be subject to adequate State-level insurance regulation. Trading by insurance companies or their affiliates that is not subject to insurance company investment regulations will not qualify for protection here.

Further, where State laws and regulations do not exist or otherwise fail to appropriately connect the insurance company investments to the actual business of insurance or are found to inadequately protect the firm, the subparagraph's conditions will not be met.

Subparagraph (d)(1)(G) permits firms to organize and offer hedge funds or private equity funds as an asset management service to clients. It is important to remember that nothing in section 619 otherwise prohibits a bank from serving as an investment adviser to an independent hedge fund or private equity fund. Yet, to serve in that capacity, a number of criteria must be met.

First, the firm must be doing so pursuant to its provision of *bona fide* trust, fiduciary, or investment advisory services to customers. Given the fiduciary obligations that come with such services, these requirements ensure that banking entities are properly engaged in responsible forms of asset management, which should tamp down on the risks taken by the relevant fund.

Second, subparagraph (d)(1)(G) provides strong protections against a firm bailing out its funds. Clause (iv) prohibits banking entities, as provided under paragraph (1) and (2) of subsection (f), from entering into lending or similar transactions with related funds, and clause (v) prohibits banking entities from "directly or indirectly, guarantee[ing], assum[ing], or otherwise insur[ing] the obligations or performance of the hedge fund or private equity fund." To prevent banking entities from engaging in backdoor bailouts of their invested funds, clause (v) extends to the hedge funds and private equity funds in which such subparagraph (G) hedge funds and private equity funds invest.

Third, to prevent a banking entity from having an incentive to bailout its funds and also to limit conflicts of interest, clause (vii) of subparagraph (G) restricts directors and employees of a banking entity from being invested in hedge funds and private equity funds organized and offered by the banking entity, except for directors or employees "directly engaged" in offering investment advisory or other services to the hedge fund or private equity fund. Fund managers can have "skin in the game" for the hedge fund or private equity fund they run, but to prevent the bank from running its general employee compensation through the hedge fund or private equity fund, other management and employees may not.

Fourth, by stating that a firm may not organize and offer a hedge fund or private equity fund with the firm's name on it, clause (vi) of subparagraph (G) further restores market discipline and supports the restriction on firms bailing out funds on the grounds of reputational risk. Similarly, clause (viii) ensures that investors recognize that the funds are subject to market discipline by requiring that funds provide prominent disclosure that any losses of a hedge fund or private equity fund are borne by investors and not by the firm, and the firm must also comply with any other restrictions to ensure that investors do not rely on the firm, including any of its affiliates or subsidiaries, for a bailout.

Fifth, the firm or its affiliates cannot make or maintain an investment interest in the fund, except in compliance with the limited fund seeding and alignment of interest provisions provided in paragraph (4) of subsection (d). This paragraph allows a firm, for the limited purpose of maintaining an investment management business, to seed a new fund or make and maintain a "de minimis" co-investment in a hedge fund or private equity fund to align the interests of the fund managers and the clients, subject to several conditions. As a general rule, firms taking advantage of this provision should maintain only small seed funds, likely to be $5 to $10 million or less. Large funds or funds that are not effectively marketed to investors would be evasions of the restrictions of this section. Similarly, co-investments designed to align the firm with its clients must not be excessive, and should not allow for firms to evade the intent of the restrictions of this section.

These "de minimis" investments are to be greatly disfavored, and subject to several significant restrictions. First, a firm may only have, in the aggregate, an immaterial amount of capital in such funds, but in no circumstance may such positions aggregate to more than 3 percent of the firm's Tier 1 capital. Second, by one year after the date of establishment for any fund, the firm must have not more than a 3 percent ownership interest. Third, investments in hedge funds and private equity funds shall be deducted on, at a minimum, a one-to-one basis from capital. As the leverage of a fund increases, the capital charges shall be increased to reflect the greater risk of loss. This is specifically intended to discourage these high-risk investments, and should be used to limit these investments to the size only necessary to facilitate asset management businesses for clients.

Subparagraphs (H) and (I) recognize rules of international regulatory comity by permitting foreign banks, regulated and backed by foreign taxpayers, in the course of operating outside of the United States to engage in activities permitted under relevant foreign law. However, these subparagraphs are not intended to permit a U.S. banking entity to avoid the restrictions on proprietary trading simply by setting up an offshore subsidiary or reincorporating offshore, and regulators should enforce them accordingly. In addition, the subparagraphs seek to maintain a level playing field by prohibiting a foreign bank from improperly offering its hedge fund and private equity fund services to U.S. persons when such offering could not be made in the United States.

Subparagraph (J) permits the regulators to add additional exceptions as necessary to "promote and protect the safety and soundness of the banking entity and the financial stability of the United States." This general exception power is intended to ensure that some unforeseen, low-risk activity is not inadvertently swept in by the prohibition on proprietary trading. However, the subparagraph sets an extremely high bar: the activity must be necessary to promote and protect the safety and soundness of the banking entity and the financial stability of the United States, and not simply pose a competitive disadvantage or a threat to firms' profitability.

Paragraph (2) of section (d) adds explicit statutory limits to the permitted activities under paragraph (1). Specifically, it prevents an activity from qualifying as a permitted activity if it would "involve or result in a material conflict of interest," "result directly or indirectly in a material exposure ..... to high-risk assets or high-risk trading strategies" or otherwise pose a threat to the safety and soundness of the firm or the financial stability of the United States.

Regulators are directed to define the key terms in the paragraph and implement the restrictions as part of the rulemaking process. Regulators should pay particular attention to the hedge funds and private equity funds organized and offered under subparagraph (G) to ensure that such activities have sufficient distance from other parts of the firm, especially those with windows into the trading flow of other clients. Hedging activities should also be particularly scrutinized to ensure that information about client trading is not improperly utilized.

The limitation on proprietary trading activities that “involve or result in a material conflict of interest” is a companion to the conflicts of interest prohibition in section 621, but applies to all types of activities rather than just asset-backed securitizations.

With respect to the definition of high-risk assets and high-risk trading strategies, regulators should pay close attention to the characteristics of assets and trading strategies that have contributed to substantial financial loss, bank failures, bankruptcies, or the collapse of financial firms or financial markets in the past, including but not limited to the crisis of 2008 and the financial crisis of 1998. In assessing high-risk assets and high-risk trading strategies, particular attention should be paid to the transparency of the markets, the availability of consistent pricing information, the depth of the markets, and the risk characteristics of the assets and strategies themselves, including any embedded leverage. Further, these characteristics should be evaluated in times of extreme market stress, such as those experienced recently. With respect to trading strategies, attention should be paid to the role that certain types of trading strategies play in times of relative market calm, as well as times of extreme market stress. While investment advisors may freely deploy high-risk strategies for their clients, attention should be paid to ensure that firms do not utilize them for their own proprietary activities. Barring high risk strategies may be particularly critical when policing market-making-related and hedging activities, as well as trading otherwise permitted under subparagraph (d)(1)(A). In this context, however, it is irrelevant whether or not a firm provides market liquidity: high-risk assets and high-risk trading strategies are never permitted.

Subsection (d), paragraph (3) directs the regulators to set appropriate additional capital charges and quantitative limits for permitted activities. These restrictions apply to both banking entities and nonbank financial companies supervised by the Board. It is left to regulators to determine if those restrictions should apply equally to both, or whether there may appropriately be a distinction between banking entities and non-bank financial companies supervised by the Board. The paragraph also mandates diversification requirements where appropriate, for example, to ensure that banking entities do not deploy their entire permitted amount of de minimis investments into a small number of hedge funds or private equity funds, or that they dangerously over-concentrate in specific products or types of financial products.

Subsection (e) provides vigorous anti-evasion authority, including record-keeping requirements. This authority is designed to allow regulators to appropriately assess the trading of firms, and aggressively enforce the text and intent of section 619.

The restrictions on proprietary trading and relationships with private funds seek to break the internal connection between a bank’s balance sheet and taking risk in the markets, with a view towards reestablishing market discipline and refocusing the bank on its credit extension function and client services. In the recent financial crisis, when funds advised by banks suffered significant losses, those off-balance sheet funds came back onto the banks' balance sheets. At times, the banks bailed out the funds because the investors in the funds had other important business with the banks. In some cases, the investors were also key personnel at the banks. Regardless of the motivations, in far too many cases, the banks that bailed out their funds ultimately relied on taxpayers to bail them out. It is precisely for this reason that the permitted activities under subparagraph (d)(1)(G) are so narrowly defined.

Indeed, a large part of protecting firms from bailing out their affiliated funds is by limiting the lending, asset purchases and sales, derivatives trading, and other relationships that a banking entity or nonbank financial company supervised by the Board may maintain with the hedge funds and private equity funds it advises. The relationships that a banking entity maintains with and services it furnishes to its advised funds can provide reasons why and the means through which a firm will bail out an advised fund, be it through a direct loan, an asset acquisition, or through writing a derivative. Further, providing advisory services to a hedge fund or private equity fund creates a conflict of interest and risk because when a banking entity is itself determining the investment strategy of a fund, it no longer can make a fully independent credit evaluation of the hedge fund or private equity fund borrower. These bailout protections will significantly benefit independent hedge funds and private equity funds, and also improve U.S. financial stability.

Accordingly, subsection (f), paragraph (1) sets forth the broad prohibition on a banking entity entering into any "covered transactions" as such term is defined in the Federal Reserve Act's section 23A, as if such banking entity were a member bank and the fund were an affiliate thereof. "Covered transactions" under section 23A includes loans, asset purchases, and, following the Dodd-Frank bill adoption, derivatives between the member bank and the affiliate. In general, section 23A sets limits on the extension of credit between such entities, but paragraph (1) of subsection (f) prohibits all such transactions. It also prohibits transactions with funds that are controlled by the advised or sponsored fund. In short, if a banking entity organizes and offers a hedge fund or private equity fund or serves as investment advisor, manager, or sponsor of a fund, the fund must seek credit, including from asset purchases and derivatives, from an independent third party.

Subsection (f), paragraph (2) applies section 23B of the Federal Reserve Act to a banking entity and its advised or sponsored hedge fund or private equity fund. This provides, inter alia, that transactions between a banking entity and its fund be conducted at arms length. The fact that section 23B also includes the provision of covered transactions under section 23A as part of its arms-length requirement should not be interpreted to undermine the strict prohibition on such transactions in paragraph (1).

Subsection (f), paragraph (3) permits the Board to allow a very limited exception to paragraph (1) for the provision of certain limited services under the rubric of "prime brokerage" between the banking entity and a third-party-advised fund in which the fund managed, sponsored, or advised by the banking entity has taken an ownership interest. Essentially, it was argued that a banking entity should not be prohibited, under proper restrictions, from providing limited services to unaffiliated funds, but in which its own advised fund may invest. Accordingly, paragraph (3) is intended to only cover third-party funds, and should not be used as a means of evading the general prohibition provided in paragraph (1). Put simply, a firm may not create tiered structures and rely upon paragraph (3) to provide these types of services to funds for which it serves as investment advisor.

Further, in recognition of the risks that are created by allowing for these services to unaffiliated funds, several additional criteria must also be met for the banking entity to take advantage of this exception. Most notably, on top of the flat prohibitions on bailouts, the statute requires the chief executive officer of firms taking advantage of this paragraph to also certify that these services are not used directly or indirectly to bail out a fund advised by the firm.

Subsection (f), paragraph (4) requires the regulatory agencies to apply additional capital charges and other restrictions to systemically significant nonbank financial institutions to account for the risks and conflicts of interest that are addressed by the prohibitions for banking entities. Such capital charges and other restrictions should be sufficiently rigorous to account for the significant amount of risks associated with these activities.

To give markets and firms an opportunity to adjust, implementation of section 620 will proceed over a period of several years. First, pursuant to subsection (b), paragraph (1), the Financial Stability Oversight Council will conduct a study to examine the most effective means of implementing the rule. Then, under paragraph (b)(2), the Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission shall each engage in rulemakings for their regulated entities, with the rulemaking coordinated for consistency through the Financial Stability Oversight Council. In coordinating the rulemaking, the Council should strive to avoid a “lowest common denominator” framework, and instead apply the best, most rigorous practice from each regulatory agency.

Pursuant to subsection (c), paragraph (1), most provisions of section 619 become effective 12 months after the issuance of final rules pursuant to subsection (b), but in no case later than 2 years after the enactment of the Dodd-Frank Act. Paragraph (c)(2) provides a 2-year period following effective date of the provision during which entities must bring their activities into conformity with the law, which may be extended for up to 3 more years. Special illiquid funds may, if necessary, receive one 5-year extension and may also continue to honor certain contractual commitments during the transition period. The purpose of this extended wind-down period is to minimize market disruption while still steadily moving firms away from the risks of the restricted activities.

The definition of “illiquid funds” set forth in subsection (h) paragraph (7) is meant to cover, in general, very illiquid private equity funds that have deployed capital to illiquid assets such as portfolio companies and real estate with a projected investment holding period of several years. The Board, in consultation with the SEC, should therefore adopt rules to define the contours of an illiquid fund as appropriate to capture the intent of the provision. To facilitate certainty in the market with respect to divestiture, the Board is to conduct a special expedited rulemaking regarding these conformance and wind-down periods. The Board is also to set capital rules and any additional restrictions to protect the banking entities and the U.S. financial system during this wind-down period.

We noted above that the purpose of section 620 is to review the long-term investments and other activities of banks. The concerns reflected in this section arise out of losses that have appeared in the long-term investment portfolios in traditional depository institutions.

Over time, various banking regulators have displayed expansive views and conflicting judgments about permissible investments for banking entities. Some of these activities, including particular trading strategies and investment assets, pose significant risks. While section 619 provides numerous restrictions to proprietary trading and relationships to hedge funds and private equity funds, it does not seek to significantly alter the traditional business of banking.

Section 620 is an attempt to reevaluate banking assets and strategies and see what types of restrictions are most appropriate. The Federal banking agencies should closely review the risks contained in the types of assets retained in the investment portfolio of depository institutions, as well as risks in affiliates' activities such as merchant banking. The review should dovetail with the determination of what constitutes "high-risk assets" and "high risk trading strategies" under paragraph (d)(2).

At this point, I yield to Senator LEVIN to discuss an issue that is of particular interest to him involving section 621's conflict of interest provisions.

Mr. LEVIN. I thank my colleague for the detailed explanation he has provided of sections 619 and 620, and fully concur in it. I would like to add our joint explanation of section 621, which addresses the blatant conflicts of interest in the underwriting of asset-backed securities highlighted in a hearing with Goldman Sachs before the Permanent Subcommittee on Investigations, which I chair.

The intent of section 621 is to prohibit underwriters, sponsors, and others who assemble asset-backed securities, from packaging and selling those securities and profiting from the securities' failures. This practice has been likened to selling someone a car with no brakes and then taking out a life insurance policy on the purchaser. In the asset-backed securities context, the sponsors and underwriters of the asset-backed securities are the parties who select and understand the underlying assets, and who are best positioned to design a security to succeed or fail. They, like the mechanic servicing a car, would know if the vehicle has been designed to fail. And so they must be prevented from securing handsome rewards for designing and selling malfunctioning vehicles that undermine the asset-backed securities markets. It is for that reason that we prohibit those entities from engaging in transactions that would involve or result in material conflicts of interest with the purchasers of their products.

Section 621 is not intended to limit the ability of an underwriter to support the value of a security in the aftermarket by providing liquidity and a ready two-sided market for it. Nor does it restrict a firm from creating a synthetic asset-backed security, which inherently contains both long and short positions with respect to securities it previously created, so long as the firm does not take the short position. But a firm that underwrites an asset-backed security would run afoul of the provision if it also takes the short position in a synthetic asset-backed security that references the same assets it created. In such an instance, even a disclosure to the purchaser of the underlying asset-backed security that the underwriter has or might in the future bet against the security will not cure the material conflict of interest.

We believe that the Securities and Exchange Commission has sufficient authority to define the contours of the rule in such a way as to remove the vast majority of conflicts of interest from these transactions, while also protecting the healthy functioning of our capital markets.

In conclusion, we would like to acknowledge all our supporters, co-sponsors, and advisers who assisted us greatly in bringing this legislation to fruition. From the time President Obama announced his support for the Volcker Rule, a diverse and collaborative effort has emerged, uniting community bankers to old school financiers to reformers. Senator *MERKLEY* and I further extend special thanks to the original cosponsors of the PROP Trading Act, Senators *TED KAUFMAN, SHERROD BROWN*, and *JEANNE SHAHEEN*, who have been with us since the beginning.

Senator *JACK REED* and his staff did yeoman's work in advancing this cause. We further tip our hat to our tireless and vocal colleague, Senator *BYRON DORGAN*, who opposed the repeal of Glass-Steagall and has been speaking about the risks from proprietary trading for a number of years. Above all, we pay tribute to the tremendous labors of Chairman *CHRIS DODD* and his entire team and staff on the Senate Banking Committee, as well as the support of Chairman *BARNEY FRANK* and Representative *PAUL KANJORSKI*. We extend our deep gratitude to our staffs, including the entire team and staff at the Permanent Subcommittee on Investigations, for their outstanding work. And last but not least, we highlight the visionary leadership of Paul Volcker and his staff. Without the support of all of them and many others, the Merkley-Levin language would not have been included in the Conference Report.

We believe this provision will stand the test of time. We hope that our regulators have learned with Congress that tearing down regulatory walls without erecting new ones undermines our financial stability and threatens economic growth. We have legislated to the best of our ability. It is now up to our regulators to fully and faithfully implement these strong provisions.

I yield the floor to Senator MERKLEY.

Mr. MERKLEY. I thank my colleague for his remarks and concur in all respects.

Mr. DODD. Mr. President, I said so yesterday, and I will say it again: I thank Senator Merkley. I guess there are four new Members of the Senate serving on the Banking Committee. Senator Merkley, Senator Warner, Senator Tester, and Senator Bennet are all new Members of the Senate from their respective States of Oregon, Virginia, Montana, and Colorado. To be thrown into what has been the largest undertaking of the Banking Committee, certainly in my three decades here—and many have argued going back almost 100 years—was certainly an awful lot to ask.

Senators Merkley and Levin – The Volcker Rule (II)

INTENT BEHIND SECTIONS 691-621

Mr. MERKLEY. Mr. President, I rise to engage my colleagues, Senators *Dodd* and *Levin*, in a colloquy regarding some key aspects of our legislative intent behind sections 619 through 621, the Merkley-Levin rule on proprietary trading and conflicts of interest as included in the conference report.

First, I would like to clarify several issues surrounding the "de minimis" investment provisions in subsection (d)(4). These provisions complement subsection (d)(1)(G), which permits firms to offer hedge funds and private equity funds to clients. "De minimis" investments under paragraph (4) are intended to facilitate these offerings principally by allowing a firm to start new funds and to maintain coinvestments in funds, which help the firm align its interests with those of its clients. During the initial start-up period, during which time firms may maintain 100 percent ownership, the fund should be relatively small, but sufficient to effectively implement the investment strategy. After the start up period, a firm may keep an ongoing "alignment of interest" coinvestment at 3 percent of a fund. Our intent is not to allow for large, revolving "seed" funds to evade the strong restrictions on proprietary trading of this section, and regulators will need to be vigilant against such evasion. The aggregate of all seed and coinvestments should be immaterial to the banking entity, and never exceed 3 percent of a firm's Tier 1 capital.

Second, I would like to clarify the intent of subsection (f)'s provisions to prohibit banking entities from bailing out funds they manage, sponsor, or advise, as well as funds in which those funds invest. The "permitted services" provisions outlined in subsection (f) are intended to permit banks to maintain certain limited "prime brokerage" service relationships with unaffiliated funds in which a fund-of-funds that they manage invests, but are not intended to permit fund-of-fund structures to be used to weaken or undermine the prohibition on bailouts. Given the risk that a banking entity may want to bail out a failing fund directly or its investors, the "permitted services" exception must be implemented in a narrow, well-defined, and arms-length manner and regulators are not empowered to create loopholes allowing high-risk activities like leveraged securities lending or repurchase agreements. While we implement a number of legal restrictions designed to ensure that prime brokerage activities are not used to bail out a fund, we expect the regulators will nevertheless need to be vigilant.

Before I yield the floor to Senator *Levin* to discuss several additional items, let me say a word of thanks to my good friend, Chairman *Dodd*, for taking the time to join me in clarifying these provisions. I also honor him for his extraordinary leadership on the entire financial reform package. As a fellow member of the Banking Committee, it has been a privilege to work with him on the entire bill, and not just these critical provisions. I also would like to recognize Senator *Levin*, whose determined efforts with his Permanent Subcommittee on Investigations helped highlight the causes of the recent crisis, as well as the need for reform. It has been a privilege working with him on this provision.

Mr. LEVIN. I thank the Senator, and I concur with his detailed explanations. His tireless efforts in putting these commonsense restrictions into law will help protect American families from reckless risk-taking that endangers our financial system and our economy.

The conflicts of interest provision under section 621 arises directly from the hearings and findings of our Permanent Subcommittee on Investigations, which dramatically showed how some firms were creating financial products, selling those products to their customers, and betting against those same products. This practice has been likened to selling someone a car with no brakes and then taking out a life insurance policy on the purchaser. In the asset-backed securities context, the sponsors and underwriters of the asset-backed securities are the parties who select and understand the underlying assets, and who are best positioned to design a security to succeed or fail. They, like the mechanic servicing a car, would know if the vehicle has been designed to fail. And so they must be prevented from securing handsome rewards for designing and selling malfunctioning vehicles that undermine the asset-backed securities markets. It is for that reason that we prohibit those entities from engaging in transactions that would involve or result in material conflicts of interest with the purchasers of their products.

First, I would like to address certain areas which we exclude from coverage. While a strong prohibition on material conflicts of interest is central to section 621, we recognize that underwriters are often asked to support issuances of asset-backed securities in the aftermarket by providing liquidity to the initial purchasers, which may mean buying and selling the securities for some time. That activity is consistent with the goal of supporting the offering, is not likely to pose a material conflict, and accordingly we are comfortable excluding it from the general prohibition. Similarly, market conditions change over time and may lead an underwriter to wish to sell the securities it holds. That is also not likely to pose a conflict. But regulators must act diligently to ensure that an underwriter is not making bets against the very financial products that it assembled and sold.

Second, I would like to address the role of disclosures in relations to conflicts of interest. In our view, disclosures alone may not cure these types of conflicts in all cases. Indeed, while a meaningful disclosure may alleviate the appearance of a material conflict of interest in some circumstances, in others, such as if the disclosures cannot be made to the appropriate party or because the disclosure is not sufficiently meaningful, disclosures are likely insufficient. Our intent is to provide the regulators with the authority and strong directive to stop the egregious practices, and not to allow for regulators to enable them to continue behind the fig leaf of vague, technically worded, fine print disclosures.

These provisions shall be interpreted strictly, and regulators are directed to use their authority to act decisively to protect our critical financial infrastructure from the risks and conflicts inherent in allowing banking entities and other large financial firms to engage in high risk proprietary trading and investing in hedge funds and private equity funds.

Mr. President, I would like to thank Chairman *Dodd* for his extraordinary dedication in shepherding this massive financial regulatory reform package through the Senate and the conference committee. This has been a long process, and he and his staff have been very able and supportive partners in this effort.

Mr. DODD. I thank the Senator, and I strongly concur with the intentions and interpretations set forth by the principal authors of these provisions, Senators *Merkley* and *Levin*, as reflecting the legislative intent of the conference committee. I thank Senators *Merkley* and *Levin* for their leadership, which was so essential in achieving the conference report provisions governing proprietary trading and prohibiting conflicts of interest.

Senator Hagan - The Volcker Rule

Mrs. HAGAN. Madam President, I rise today to discuss the conference agreement on financial services regulatory reform and specifically an issue in section 619 of title VI, known as the Volcker rule. The section's limitations on financial organizations that own a depository institution from investing or sponsoring in hedge funds or investments in private equity to 3 percent of an organization's assets, in the aggregate, references "tier 1 capital."

The term "tier 1 capital" is a concept currently applied strictly to banks and bank holding companies and consists of core capital, which includes equity capital and disclosed reserves. However, there are financial organizations subject to the Volcker rule's investment constraints that do not have a principal regulator that utilizes tier 1 capital measurements to determine an entity's financial strength. In order to ensure a level playing field with traditional banks, I would hope the appropriate regulators would determine a suitable equivalent of tier 1 capital to determine the investment limit, while still satisfying the intent of the Volcker rule.

I ask the regulators to make certain that these types of financial organizations will be subject to the Volcker rule in a manner that takes into account their unique structure.

In addition, I am pleased that as part of the conference report that the Volcker language was modified to permit a banking entity to engage in a certain level of traditional asset management business, including the ability to sponsor and offer hedge and private equity funds. With that in mind, I wanted to clarify certain details around this authority.

First, I was pleased to see that the Volcker Rule, as modified, will permit banking entities several years to bring their full range of activities into conformance with the new rule. In particular, section 619(c)(2) ensures that the new investment restrictions under section 619(d)(1)(G)(iii) and section 619(d)(4)—including the numerical limitations under section 619(d)(4)(B)(ii)—will only apply to a banking entity at the end of the period that is 2 years after the section's effective date. This date for the regulators to begin applying the new rules can also be extended into the future for up to three 1-year periods under section 619(c)(2) and can also separately be extended for illiquid funds with contractual commitments as of May 1, 2010, under section 619(c)(3), on a one-time basis for up to 5 years. Only after all of these time periods and extensions have run will any of the limitations under section 619(d)(1)(G) and section 619(d)(4) be applied by regulators.

Second, as an added protection, section 619(f) applies sections 23A and 23B of the Federal Reserve Act to transactions between all of a banking entity's affiliates and hedge or private equity funds where the banking entity organizes, offers, serves as an investment manager, investment adviser, or sponsor of such funds under section 619(d). These restrictions are also applied to transactions between a banking entity's affiliates and other funds that are "controlled" by a hedge or private equity fund permitted for the banking entity under 619(d). Importantly, these 23A and 23B restrictions do not apply to funds not "controlled" by funds permitted for the banking entity under section 619(d), and it should also be clear that under section 619 there are no new restrictions or limitations of any type placed on the portfolio investments of any hedge or private equity fund permitted for a banking entity under section 619.

Third, as a condition of sponsorship, section 619(d)(1)(G)(v) requires that a banking entity does not, directly or indirectly, guarantee or assume or otherwise insure the obligations or performance of any sponsored hedge or private equity fund or of any other hedge or private equity fund in which the sponsored fund invests. While this restricts guarantees by the banking entity as well as the insuring of obligation or performance, it does not limit other normal banking relations with funds merely due to a noncontrol investment by a fund sponsored by the banking entity. As described above, section 619(f) limits transactions under 23A and 23B of the Federal Reserve Act with a fund "controlled" by the banking entity or a fund sponsored by the banking entity. However, 619(f) does not limit in any manner transactions and normal banking relationships with a fund not "controlled" by the banking entity or a fund sponsored by the banking entity.

Finally, section 619(d)(4)(I) permits certain banking entities to operate hedge and private equity funds outside of the United States provided that no ownership interest in any hedge or private equity fund is offered for sale or sold to a U.S. resident. For consistency's sake, I would expect that, apart from the U.S. marketing restrictions, these provisions will be applied by the regulators in conformity with and incorporating the Federal Reserve's current precedents, rulings, positions, and practices under sections 4(c)(9) and 4(c)(13) of the Bank Holding Company Act so as to provide greater certainty and utilize the established legal framework for funds operated by bank holding companies outside of the United States.

Senator Bayh – The Volcker Rule

VOLCKER RULE

Mr. BAYH. I thank the Chairman. With respect to the Volcker Rule, the conference report states that banking entities are not prohibited from purchasing and disposing of securities and other instruments in connection with underwriting or market making activities, provided that activity does not exceed the reasonably expected near term demands of clients, customers, or counterparties. I want to clarify this language would allow banks to maintain an appropriate dealer inventory and residual risk positions, which are essential parts of the market making function. Without that flexibility, market makers would not be able to provide liquidity to markets.

Mr. DODD. The gentleman is correct in his description of the language.

Senator Boxer – The Volcker Rule

VOLCKER RULE

Mrs. BOXER. Mr. President, I wish to ask my good friend, the Senator from Connecticut and the chairman of the Banking Committee, to engage in a brief discussion relating to the final Volcker rule and the role of venture capital in creating jobs and growing companies.

I strongly support the Dodd-Frank Wall Street Reform and Consumer Protection Act, including a strong and effective Volcker rule, which is found in section 619 of the legislation.

I know the chairman recognizes, as we all do, the crucial and unique role that venture capital plays in spurring innovation, creating jobs and growing companies. I also know the authors of this bill do not intend the Volcker rule to cut off sources of capital for America's technology startups, particularly in this difficult economy. Section 619 explicitly exempts small business investment companies from the rule, and because these companies often provide venture capital investment, I believe the intent of the rule is not to harm venture capital investment.

Is my understanding correct?

Mr. DODD. Mr. President, I thank my friend, the Senator from California, for her support and for all the work we have done together on this important issue. Her understanding is correct.

The purpose of the Volcker rule is to eliminate excessive risk taking activities by banks and their affiliates while at the same time preserving safe, sound investment activities that serve the public interest. It prohibits proprietary trading and limits bank investment in hedge funds and private equity for that reason. But properly conducted venture capital investment will not cause the harms at which the Volcker rule is directed. In the event that properly conducted venture capital investment is excessively restricted by the provisions of section 619, I would expect the appropriate Federal regulators to exempt it using their authority under section 619(J).

Senator Lincoln – Title VII

Mrs. LINCOLN. Mr. President, as I have previously discussed, section 737 of H.R. 4173 will grant broad authority to the Commodity Futures Trading Commission to once and for all set aggregate position limits across all markets on non-commercial market participants. During consideration of this bill we all learned many valuable lessons about how the commodities markets operate and the impact that highly leveraged, and heretofore unregulated swaps, have on the price discovery function in the futures markets. I believe the adoption of aggregate position limits, along with greater transparency, will help bring some normalcy back to our markets and reduce some of the volatility we have witnessed over the last few years.

I also recognize that in setting these limits, regulators must balance the needs of market participants, while at the same time ensuring that our markets remain liquid so as to afford end-users and producers of commodities the ability to hedge their commercial risk. Along these lines I do believe that there is a legitimate role to be played by market participants that are willing to enter into futures positions opposite a commercial end-user or producer. Through this process the markets gain additional liquidity and accurate price discovery can be found for end-users and producers of commodities.

However, I still hold some reservations about these financial market participants and the negative impact of excessive speculation or long only positions on the commodities markets. While I have concerns about the role these participants play in the markets, I do believe that important distinctions in setting position limits on these participants are warranted. In implementing section 737, I would encourage the CFTC to give due consideration to trading activity that is unleveraged or fully collateralized, solely exchange-traded, fully transparent, clearinghouse guaranteed, and poses no systemic risk to the clearing system. This type of trading activity is distinguishable from highly leveraged swaps trading, which not only poses systemic risk absent the proper safeguards that an exchange traded, cleared system provides, but also may distort price discovery. Further, I would encourage the CFTC to consider whether it is appropriate to aggregate the positions of entities advised by the same advisor where such entities have different and systematically determined investment objectives.

I wish to also point out that section 719 of the conference report calls for a study of position limits to be undertaken by the CFTC. In conducting that study, it is my expectation that the CFTC will address the soundness of prudential investing by pension funds, index funds and other institutional investors in unleveraged indices of commodities that may also serve to provide agricultural and other commodity contracts with the necessary liquidity to assist in price discovery and hedging for the commercial users of such contracts.

Mr. President, as the Chairman of the Senate Committee on Agriculture, Nutrition and Forestry, I am proud to say that the bill coming out of our committee was the base text for the derivatives title in the Senate passed bill. The Senate passed bill's derivatives title was the base text used by the conference committee. The conference committee made changes to the derivatives title, adopting several provisions from the House passed bill. The additional materials that I am submitting today are primarily focused on the derivatives title of the conference report. They are intended to provide clarifying legislative history regarding certain provisions of the derivatives title and how they are supposed to work together.

I ask unanimous consent that this material be printed in the RECORD.

There being no objection, the material was ordered to be printed in the RECORD, as follows:

The major components of the derivatives title include: 100 percent reporting of swaps and security-based swaps, mandatory trading and clearing of standardized swaps and security-based swaps, and real-time price reporting for all swap transactions—those subject to mandatory trading and clearing as well as those subject to the end user clearing exemption and customized swaps. Swap dealers, security-based swap dealers, major swap participants and major security-based swap participants will all be required to register with either the Commodity Futures Trading Commission, CFTC, or the Securities and Exchange Commission, SEC, and meet additional requirements including capital, margin, reporting, examination, and business conduct requirements. All swaps that are "traded" must be traded on either a designated contract market or a swap execution facility. All security-based swaps must be traded on either a national securities exchange or a security-based swap execution facility. It is a sea change for the $600 trillion swaps market. Swaps and security-based swaps which are not subject to mandatory exchange trading or clearing will be required to submit transaction data to swap data repositories or security-based swap data repositories. These new "data repositories" will be required to register with the CFTC and SEC and be subject to statutory duties and core principals which will assist the CFTC and SEC in their oversight and market regulation responsibilities.

There are several important definitional and jurisdictional provisions in title VII. For instance, the new definitions of "swap" and "security-based swap" are designed to maintain the existing Shad Johnson jurisdictional lines between the CFTC and the SEC which have been in place since 1982. Under the Shad Johnson accord, the CFTC has jurisdiction over commodity-based instruments as well as futures and options on broad-based security indices (and now swaps), while the SEC has jurisdiction over security-based instruments—both single name and narrow-based security indices—and now security-based swaps. The Shad Johnson jurisdictional lines were reaffirmed in 2000 with the passage of the Commodity Futures Modernization Act, CFMA, as it related to security futures products. Maintaining existing jurisdictional lines between the two agencies was an important goal of the Administration, as reflected in their draft legislation. This priority was reflected in the bills passed out of the Senate and House agricultural committees and through our respective chambers and now reflected in the conference report.

As noted above, the conference report maintains the Shad Johnson jurisdictional accord. We made it clear that the CFTC has jurisdiction under Section 2(a)(1) of the Commodity Exchange Act, "CEA", over both interest rate swaps and foreign exchange swaps and forwards. The definition of "swap" under the CEA specifically lists interest rate swaps as being a swap. This is CEA Section 1a(47)(A)(iii)(I). This is appropriate as the CFTC has a long history of overseeing interest rate futures. The futures exchanges have listed and traded interest rate contracts for nearly 40 years. The CME has listed for trading quarterly settled interest rate swap future contracts. In the last 24 months, some designated contract markets have listed futures contracts which mirror interest rate swaps in design, function, maturity date and all other material aspects. In addition, some of the CFTC registered clearing houses have listed and started to clear both these interest rate swap futures contracts as well as interest rate swap contracts. This is on top of the nearly $200 trillion in interest rate swap contracts which have been cleared at LCH.Clearnet in London.

Also, under this legislation, foreign exchange swaps and forwards come under the CFTC's jurisdiction under Section 2(a)(1) of the CEA. We listed in the definition of "swap" certain types of common swaps, including "foreign exchange swaps" so it would be clear that they are regulated under the CEA. See CEA Section 1a(47)(A)(iii)(VIII). In addition, the terms "foreign exchange forward" and "foreign exchange swap" are defined in the CEA itself. See CEA Section 1a(24) and (25). One should note that foreign exchange forwards are treated as swaps under the CEA.

The CEA as amended permits the Secretary of the Treasury to make a written determination to exempt either or both foreign exchange swaps and or foreign exchange forwards from the mandatory trading and clearing requirements of the CEA, which applies to swaps generally. Under new Section 1b of the CEA, the Secretary must consider certain factors in determining whether to exempt either foreign exchange swaps or foreign exchange forwards from being treated like all other swaps. These factors include: (1) whether the required trading and clearing of foreign exchange swaps and foreign exchange forwards would create systemic risk, lower transparency, or threaten the financial stability of the United States; (2) whether foreign exchange swaps and foreign exchange forwards are already subject to a regulatory scheme that is materially comparable to that established by this Act for other classes of swaps; (3) the extent to which bank regulators of participants in the foreign exchange market provide adequate supervision, including capital and margin requirements; (4) the extent of adequate payment and settlement systems; and (5) the use of a potential exemption of foreign exchange swaps and foreign exchange forwards to evade otherwise applicable regulatory requirements. In making a written determination to exempt such swaps from regulation, the Secretary must make certain findings. The Secretary's written determination is not effective until it is filed with the appropriate Congressional Committees and provides the following information: (1) an explanation regarding why foreign exchange swaps and foreign exchange forwards are qualitatively different from other classes of swaps in a way that would make the foreign exchange swaps and foreign exchange forwards ill-suited for regulation as swaps; and (2) an identification of the objective differences of foreign exchange swaps and foreign exchange forwards with respect to standard swaps that warrant an exempted status. These provisions and this process related to exempting foreign exchange swaps and foreign exchange forwards from swaps regulation will be, and should be, difficult for the Secretary of the Treasury to meet. The foreign exchange swaps and foreign exchange forward market is approximately $65 trillion and the second largest part of the swaps market. It is important that the foreign exchange swaps market be transparent as well as subject to comprehensive and vigorous market oversight so there are no questions about possible manipulation of currencies or exchange rates.

I would also note that we have made it clear that even if foreign exchange swaps and forwards are exempted by the Secretary of the Treasury from the mandatory trading and clearing requirements which are applicable to standardized swaps, that all foreign exchange swaps and forwards transactions must be reported to a swap data repository under the CFTC's jurisdiction. In addition, we have made it clear that to the extent foreign exchange swaps and forwards are listed for trading on a designated contract market or cleared through a registered derivatives clearing organization that such swap contracts are subject to the CFTC's jurisdiction under the CEA and that the CFTC retains its jurisdiction over retail foreign exchange transactions.

We have made some progress in this legislation with respect to clarifying CFTC jurisdiction and preserving SEC enforcement jurisdiction over instruments which are "security-based swap agreements." Security-based swap agreements are actually "swaps" and subject to both the CFTC and the SEC's jurisdiction. One will notice that we have inserted the definition of "security-based swap agreements" in both the Commodity Exchange Act and the Securities and Exchange Act—section 1a(47)(A)(v) of the CEA (7 U.S.C. 1a(47)(A)(v)) and section 3(a)(78) of the SEA of 1934 (15 U.S.C. 78c(a)(78)). The term "security-based swap agreement" is a hold-over term from the CFMA of 2000. In the CFMA, Congress chose to exclude "swap agreements" from regulation by the CFTC and "security-based swap agreements" from regulation by the SEC. While the CFMA exclusions were broad, the SEC retained limited authority—anti fraud and anti manipulation enforcement authority—with respect to security-based swap agreements. The Agriculture Committee and Congress chose to preserve that existing enforcement jurisdiction of the SEC related to those swaps which qualify as security-based swap agreements. The swaps which will qualify as security-based swap agreements is quite limited. It would appear that non narrow-based security index swaps and credit default swaps may be the only swaps considered to be security-based swap agreements. The rationale for providing the SEC with enforcement authority with respect to security-based swap agreements in the CFMA was premised on the fact that the CFTC didn't have as extensive an anti-fraud or anti-manipulation authority as the SEC. This lack of CFTC authority was remedied in the title VII so that the CFTC now has the same authority as the SEC. It is good policy to have a second set of enforcement eyes in this area. The SEC can and should be able to back up the CFTC on enforcement issues without interceding in the main market and product regulation. In the new legislation, we repeal the specific exclusions related to swap agreements and security-based swap agreements in both the CEA and the Securities Exchange Act of 1934, "SEA". One should note that the definition of "security-based swap agreement" in the SEA specifically excludes any "security-based swap", which means that SBSAs are really swaps. This point is made clear in the definition of "swap" under the CEA. Under Section 1a(47)(A)(v) it states that "any security-based swap agreement which meets the definition of "swap agreement" as defined in Section 206A of the Gramm-Leach-Bliley Act of which a material term is based on the price, yield, value or volatility of any security, or any group or index of securities, or any interest therein." Regulators should note that Congress chose to refer to security-based swap agreements as swaps at several points in the CEA. Further, the CFTC and the SEC, after consultation with the Federal Reserve, are to undertake a joint rulemaking related to security-based swap agreements. The regulators should follow Congressional intent in this area and preserve the SEC's anti-fraud and anti-manipulation enforcement authority for that limited group of swaps which are considered to be security-based swap agreements.

We have introduced a new term in this legislation, which is "mixed swap". The term is found in both the CEA and the SEA—CEA Section 1a(47)(D) and SEA Section 3(a)(68)(D). The term is subject to a joint rulemaking between the CFTC and the SEC. The term "mixed swap" refers to those swaps which have attributes of both security-based swaps and regular swaps. A "mixed swap" is somewhat similar to a "hybrid product" under the CEA which has attributes of both securities and futures. CEA Section 2(f). Hybrid products must be predominantly securities to be excluded from regulation as contracts of sale of a commodity for future delivery under the CEA. While there is no "predominance" or "primarily" test in the definition of "mixed swap" the regulators should ensure that when deciding the jurisdictional allocation of such mixed swaps in the joint rulemaking process, that mixed swaps should be allocated to either the CFTC or the SEC based on clear and unambiguous criteria like a primarily test. A de minimis amount of security-based swap attributes should not bring a swap into the SEC's jurisdiction just as a de minimis amount of swap attributes should not bring a security-based swap into the CFTC's jurisdiction. While there will be some difficult decisions to be made on individual swap contracts, it will be fairly clear most of the time whether a particular swap is more security-based swap or swap. We expect the regulators to be reasonable in their joint rulemaking and interpretations.

The mandatory clearing and trading of certain swaps and security-based swaps, along with real-time price reporting, is at the heart of swaps market reform. Under the conference report, swaps and security-based swaps determined to be subject to the mandatory clearing requirement by the regulators would also be required to be traded on a designated contract market, a national securities exchange, or new swap execution facilities or security-based swap execution facilities. To avoid any conflict of interests, the regulators—the CFTC and the SEC—will make a determination as to what swaps must be cleared following certain statutory factors. It is expected that the standardized, plain vanilla, high volume swaps contracts—which according to the Treasury Department are about 90 percent of the $600 trillion swaps market—will be subject to mandatory clearing. Derivatives clearing organizations and clearing agencies are required to submit all swaps and security-based swaps for review and mandatory clearing determination by regulators. It will also be unlawful for any entity to enter into a swap without submitting it for clearing if that swap has been determined to be required to clear. It is our understanding that approximately 1,200 swaps and security-based swaps contracts are currently listed by CFTC-registered clearing houses and SEC-registered clearing agencies for clearing. Under the conference report, these 1,200 swaps and security-based swaps already listed for clearing are deemed "submitted" to the regulators for review upon the date of enactment. It is my expectation that the regulators, who are already familiar with these 1,200 swap and security-based swap contracts, will work within the 90 day time frame they are provided to identify which of the current 1,200 swap and security-based swap agreements should be subject to mandatory clearing requirements. The regulators may also identify and review swaps and security-based swaps which are not submitted for clearinghouse or clearing agency listing and determine that they are or should be subject to mandatory clearing requirement. This provision is considered to be an important provision by senior members of the Senate Agriculture Committee, as it removes the ability for the clearinghouse or clearing agency to block a mandatory clearing determination.

The conference report also contains an end user clearing exemption. Under the conference report, end users have the option, but not the obligation, to clear or not clear their swaps and security-based swaps that have been determined to be required to clear, as long as those swaps are being used to hedge or mitigate commercial risk. This option is solely the end users' right. If the end user opts to clear a swap, the end user also has the right to choose the clearing house where the swap will be cleared. Further, the end user has the right, but not the obligation, to force clearing of any swap or security-based swap which is listed for clearing by a clearing house or clearing agency but which is not subject to mandatory clearing requirement. Again the end user has the right to choose the clearing house or clearing agency where the swap or security-based swap will be cleared. The option to clear is meant to empower end users and address the disparity in market power between the end users and the swap dealers. Under the conference report, certain specified financial entities are prohibited from using the end user clearing exemption. While most large financial entities are not eligible to use the end user clearing exemption for standardized swaps entered into with third parties, it would appropriate for regulators to exempt from mandatory clearing and trading inter affiliate swap transactions which are between for wholly-owned affiliates of a financial entity. We would further note that small financial entities, such as banks, credit unions and farm credit institutions below $10 billion in assets—and possibly larger entities—will be permitted to utilize the end user clearing exemption with approval from the regulators. The conference report also includes an anti-evasion provision which provides the CFTC and SEC with authority to review and take action against entities which abuse the end user clearing exemption.

In addition to the mandatory clearing and trading of swaps discussed above, the conference report retains and expands the Senate Agriculture Committee's real time swap transaction and price reporting requirements. The Agriculture Committee focused on swap market transparency while it was constructing the derivatives title. As stated earlier, the conference report requires 100% of all swaps transactions to be reported. It was universally agreed that regulators should have access to all swaps data in real time. On the other hand, there was some outstanding questions regarding the capacity, utility and benefits from public reporting of swaps transaction and pricing data. I would like to respond to those questions. Market participants—including exchanges, contract markets, brokers, clearing houses and clearing agencies—were consulted and affirmed that the existing communications and data infrastructure for the swaps markets could accommodate real time swap transaction and price reporting. Speaking to the benefits of such a reporting requirement, the committee could not ignore the experience of the U.S. Securities and Futures markets. These markets have had public disclosure of real time transaction and pricing data for decades. We concluded that real time swap transaction and price reporting will narrow swap bid/ask spreads, make for a more efficient swaps market and benefit consumers/counterparties overall. For these reasons, the Senate Agriculture Committee required "real time" price reporting for: (1) All swap transactions which are subject to mandatory clearing requirement; (2) All swaps under the end user clearing exemption which are not cleared but reported to a swap data repository subject; and, (3) all swaps which aren't subject to the mandatory clearing requirement but which are cleared at a clearing house or clearing agency—under permissive, as opposed to mandatory, clearing. The conference report adopted this Senate approach with one notable addition authored by Senator Reed. The Reed amendment, which the conference adopted, extended real time swap transaction and pricing data reporting to "non-standardized" swaps which are reported to swap data repositories and security-based swap data repositories. Regulators are to ensure that the public reporting of swap transactions and pricing data does not disclose the names or identities of the parties to the transactions.

I would like to specifically note the treatment of "block trades" or "large notional" swap transactions. Block trades, which are transactions involving a very large number of shares or dollar amount of a particular security or commodity and which transactions could move the market price for the security or contract, are very common in the securities and futures markets. Block trades, which are normally arranged privately, off exchange, are subject to certain minimum size requirements and time delayed reporting. Under the conference report, the regulators are given authority to establish what constitutes a "block trade" or "large notional" swap transaction for particular contracts and commodities as well as an appropriate time delay in reporting such transaction to the public. The committee expects the regulators to distinguish between different types of swaps based on the commodity involved, size of the market, term of the contract and liquidity in that contract and related contracts, i.e.; for instance the size/dollar amount of what constitutes a block trade in 10-year interest rate swap, 2-year dollar/euro swap, 5-year CDS, 3-year gold swap, or a 1-year unleaded gasoline swap are all going to be different. While we expect the regulators to distinguish between particular contracts and markets, the guiding principal in setting appropriate block-trade levels should be that the vast majority of swap transactions should be exposed to the public market through exchange trading. With respect to delays in public reporting of block trades, we expect the regulators to keep the reporting delays as short as possible.

I firmly believe that taking the Senate bill language improved the final conference report by strengthening the regulators enforcement authority dramatically. The Senate Agriculture Committee looked at existing enforcement authority and tried to give the CFTC the authority which it needs to police both the futures and swaps markets. As I mentioned above, we provided the CFTC with anti-fraud and anti-manipulation authority equal to that of the SEC with respect to non narrow-based security index futures and swaps so as to equalize the SEC and CFTC enforcement authority in this area. The CFTC requested, and received, enforcement authority with respect to insider trading, restitution authority, and disruptive trading practices. In addition, we added in anti-manipulation authority from my good friend Senator Cantwell. Senator Cantwell and I were concerned with swaps participants knowingly and intentionally avoiding the mandatory clearing requirement. We were able to reach an agreement with the other committees of jurisdiction by providing additional enforcement authority that I believe will address the root problem. Further, I would be remiss in not mentioning that we provided specific enforcement authority under Section 9 for the CFTC to bring actions against persons who purposely evade the mandatory clearing requirement. This provision is supposed to work together with the anti-evasion provision in the clearing section. Another important provision is one related to fraud and an episode earlier this year involving Greece and the use of cross currency swaps. We gave new authority to the CFTC to go after persons who enter into a swap knowing that its counterparty intends to use the swap for purposes of defrauding a third party. This authority, which is meant to expand the CFTC's existing aiding and abetting authority, should permit the CFTC to bring actions against swap dealers and others who assist their counterparties in perpetrating frauds on third parties. All in all, the CFTC's enforcement authority was expanded to meet known problems and fill existing holes. It should give them the tools which are necessary to police this market.

A significant issue which was fixed during conference was clarifying that in most situations community banks aren't swap dealers or major swap participants. The definition of swap dealer was adjusted in a couple of respects so that a community bank which is hedging its interest rate risk on its loan portfolio would not be viewed as a Swap Dealer. In addition, we made it clear that a bank that originates a loan with a customer and offers a swap in connection with that loan shouldn't be viewed as a swap dealer. It was never the intention of the Senate Agriculture Committee to catch community banks in either situation. We worked very hard to make sure that this understanding came through in revised statutory language which was worked out during conference. There were some concerns expressed about banks being caught up as being highly leveraged financial entities under prong (iii) of the major swap participant definition. This concern was addressed by adding language clarifying that if the financial entity had a capital requirement set by a federal banking regulator that it wouldn't be included in the definition under that prong. This particular prong of the major swap participant provision was intended to catch entities like the hedge fund LTCM and AIG's financial products subsidiary, not community banks. We also clarified in Section 716 that banks which are major swap participants are not subject to the federal assistance bans. These changes and clarifications should ensure that community banks, when acting as banks, are not caught by the swap dealer or major swap participant definitions.

Section 716 and the ban on federal assistance to swap entities is an incredibly important provision. It was agreed by the administration, and accepted by the conference, that under the revised Section 716, insured depository institutions would be forced to "push out" the riskiest swap activities into a separate affiliate. The swap dealer activities which would have to be pushed out included: swaps on equities, energy, agriculture, metal other than silver and gold, non investment grade debt, uncleared credit default swaps and other swaps that are not bank permissible investments. We were assured by the administration that all of the types of swaps enumerated above are not bank permissible and will be subject to the push out. Further, it is our understanding that no regulatory action, interpretation or guidance will be issued or taken which might turn such swaps into bank permissible investments or activities.

It should also be noted that a mini-Volcker rule was incorporated into Section 716 during the conference. Banks, their affiliates and their bank holding companies would be prohibited from engaging in proprietary trading in derivatives. This provision would prohibit banks and bank holding companies, or any affiliate, from proprietary trading in swaps as well as other derivatives. This was an important expansion and linking of the Lincoln Rule in Section 716 with the Volcker Rule in Section 619 of Dodd-Frank.

Section 716's effective date is 2 years from the effective date of the title, with the possibility of a 1 year extension by the appropriate Federal banking agency. It should be noted that the appropriate federal banking agencies should be looking at the affected banks and evaluating the appropriate length of time which a bank should receive in connection with its "push out." Under the revised Section 716, banks do not have a "right" to 24 month phase-in for the push out of the impermissible swap activities. The appropriate federal banking agencies should be evaluating the particular banks and their circumstances under the statutory factors to determine the appropriate time frame for the push out.

The Senate Agriculture Committee bill revised and updated several of the CEA definitions related to intermediaries such as floor trader, floor broker, introducing broker, futures commission merchant, commodity trading advisor, and commodity pool operator as well as adding a statutory definition of the term commodity pool. We note that the definition of futures commission merchant is amended to include persons that are registered as FCMs. This makes clear that such persons must comply with the regulatory standards, including the capital and customer funds protections that apply to FCMs. The Senate Agriculture Committee wanted to ensure that all the intermediary and other definitions were current and reflected the activities and financial instruments which CFTC registered and regulated entities would be advising on, trading or holding, especially in light of Congress adding swaps to the financial instruments over which the CFTC has jurisdiction. We note that in addition to swaps, we added other financial instruments such as security futures products, leverage contracts, retail foreign exchange contracts and retail commodity transactions which the CFTC has jurisdiction over and which would require registration where appropriate.

With respect to commodity trading advisors, CTAs, commodity pool operators, CPOs, and commodity pools, we wanted to provide clarity regarding the activities and jurisdiction over these entities. Under Section 749 we have provided additional clarity regarding what it means to be "primarily engaged" in the business of being a commodity trading advisor and being a commodity pool. To the extent an entity is "primarily engaged" in advising on swaps, such as interest rate swaps, foreign exchange swaps or broad-based security index swaps, then it would be required to register as a commodity trading advisor with the CFTC. On the other hand, to the extent an entity is primarily engaged in advising on security-based swaps it would be required register as an investment adviser with the SEC or the states. We would note that under existing law the CEA and the Investment Advisers Act have mirror provisions which exempts from dual registration and regulation SEC registered IAs and CFTC registered CTAs as long as they only provide very limited advice related to futures and securities, respectively. This policy is continued and expanded to the extent it now covers advice related to swaps and security-based swaps.

With respect to commodity pools, the SEC has long recognized that commodity pools are not investment companies which are subject to registration or regulation under the Investment Company Act of 1940. Alpha Delta Fund No Action Letter (pub avail. May 4, 1976); Peavey Commodity Futures Fund I, II and III No action letter (pub avail. June 2, 1983)); Managed Futures Association No Action Letter (Pub Avail. July 15, 1996). To be an "investment company" under Section 3(a) of the Investment Company Act an entity has to be primarily engaged in the business of investing, reinvesting, or trading securities. In the matter of the Tonopah Mining Company of Nevada, 26 S.E.C. 426 (July 22, 1947) and *SEC v. National Presto Industries, Inc.*, 486 F.3d 305 (7th Cir. 2007). Commodity pools are primarily engaged in the business of investing, reinvesting or trading in commodity interests, not securities. For this reason, commodity pools are not investment companies and are not utilizing an exemption under the Investment Company Act. A recent and well know example of commodity pools which the SEC has recognized as not being investment companies, and not being required to register under the Investment Company Act, comes in the commodity based exchange traded funds (ETF) world. While recent ETFs based on gold, silver, oil, natural gas and other commodities have registered their securities under the 1933 and 1934 Acts and listed them on national securities exchanges for trading, these funds, which are commodity pools which are operated by CFTC registered commodity pool operators, are not registered as investment companies under the Investment Company Act of 1940. See the Investment Company Institute 2010 Fact Book, Chapter 3. We have clarified that commodity interests include not only contracts of sale of a commodity for future delivery and options on such contracts but would also include swaps, security futures products, leverage contracts, retail foreign exchange contracts, retail commodity transactions, physical commodities and any funds held in a margin account for trading such instruments. I am pleased that the Conference Report includes these new provisions which were in the bill passed out of the Senate Agriculture Committee.

I would also note the importance of Section 769 and Section 770. These sections amend the Investment Company Act of 1940 and the Investment Advisers Act of 1940 so that certain terms in the CEA are now incorporated into both of the 1940 Acts, which are administered by the SEC. We believed it was appropriate to incorporate these important definitions from the CEA into the two 1940 Acts as it relates to advice on futures and swaps, such as interest rate swaps and foreign exchange swaps and forwards, as well as what constitutes being a commodity pool and being primarily engaged in the business of investing in commodity interests as distinguished from being an investment company which is primarily engaged in the business of investing, reinvesting, holding, trading securities. I am pleased that the Conference Report includes these new updated definitions as it should help clarify jurisdictional and registration requirements.

Another extremely important issue which originated in the Senate Agriculture Committee was imposing a fiduciary duty on swap dealers when dealing with special entities, such as municipalities, pension funds, endowments, and retirement plans. The problems in this area, especially with respect to municipalities and Jefferson County, Alabama in particular are very well known. I would like to note that Senators Harkin and Casey have been quite active in this area and worked closely with me on this issue. While Senators Harkin, Casey and I did not get everything which we were looking for, we ended up with a very good product. First, there is a clear fiduciary duty which swap dealers and major swap participants must meet when acting as advisors to special entities. This is a dramatic improvement over the House passed bill and should help protect both tax payers and plan beneficiaries. Further, we have expanded the business conduct standards which swap dealers and major swap participants must follow even when they are not acting as advisors to special entities. I'd make a very important point, nothing in this provision prohibits a swap dealer from entering into transactions with special entities. Indeed, we believe it will be quite common that swap dealers will both provide advice and offer to enter into or enter into a swap with a special entity. However, unlike the status quo, in this case, the swap dealer would be subject to both the acting as advisor and business conduct requirements under subsections (h)(4) and (h)(5). These provisions will place tighter requirements on swap entities that we believe will help to prevent many of the abuses we have seen over the last few years. Importantly, the CFTC and the SEC have the authority to add to the statutory business conduct standards which swap dealers and major swap participants must follow. We expect the regulators to utilize this authority. Among other areas, regulators should consider whether to impose business conduct standards that would require swap dealers to further disclose fees and compensation, ensure that swap dealers maintain the confidentiality of hedging and portfolio information provided by special entities, and prohibit swap dealers from using information received from a special entity to engage in trades that would take advantage of the special entity's positions or strategies. These are very important issues and should be addressed.

Section 713 clarifies the authority and means for the CFTC and SEC to facilitate portfolio margining of futures positions and securities positions together, subject to account-specific programs. The agencies are required to consult with each other to ensure that such transactions and accounts are subject to "comparable requirements to the extent practicable for similar products." The term "comparable" in this provision does not mean "identical." Rather, the term is intended to recognize the legal and operational differences of the regulatory regimes governing futures and securities accounts.

Title VII establishes a new process for the CFTC and SEC to resolve the status of novel derivative products. In the past, these types of novel and innovative products have gotten caught up in protracted jurisdictional disputes between the agencies, resulting in delays in bringing products to market and placing U.S. firms and exchanges at a competitive disadvantage to their overseas counterparts.

In their Joint Harmonization Report from October 2009, the two agencies recommended legislation to provide legal certainty with respect to novel derivative product listings, either by a legal determination about the nature of a product or through the use of the agencies' respective exemptive authorities. Title VII includes provisions in Sections 717 and 718 to implement these recommendations.

It does so by establishing a process that requires public accountability by ensuring that jurisdictional disputes are resolved at the Commission rather than staff level, and within a firm timeframe. Specifically, either agency can request that the other one: 1) make a legal determination whether a particular product is a security under SEC jurisdiction or a futures contract or commodity option under CFTC jurisdiction; or 2) grant an exemption with respect to the product. An agency receiving such a request from the other agency is to act on it within 120 days. Title VII also provides for an expedited judicial review process for a legal determination where the agency making the request disagrees with the other's determination.

Title VII also includes amendments to existing law to ensure that if either agency grants an exemption, the product will be subject to the other's jurisdiction, so there will be no regulatory gaps. For example, the Commodity Exchange Act is amended to clarify that CFTC has jurisdiction over options on securities and security indexes that are exempted by the SEC. And Section 741 grants the CFTC insider trading enforcement authority over futures, options on futures, and swaps, on a group or index of securities.

We strongly urge the agencies to work together under these new provisions to alleviate the ills that they themselves have identified. The agencies should make liberal use of their exemptive authorities to avoid spending taxpayer resources on legal fights over whether these novel derivative products are securities or futures, and to permit these important new products to trade in either or both a CFTC- or SEC-regulated environment.

Section 721 includes a broad and expansive definition of the term "swap" that is subject to the new regulatory regime established in Title VII. It also provides the CFTC with the authority to further define the term "swap" (and various other new terms in Title VII) in order to include transactions and entities that have been structured to evade these important new legal requirements. The CFTC must not allow market participants to "game the system" by labeling or structuring transactions that are swaps as another type of instrument and then claim the instrument to be outside the scope of the legislation that Congress has enacted.

Section 723 creates a "Trade Execution Requirement" in new section 2(h)(8) of the Commodity Exchange Act (CEA). Section 2(h)(8)(A) requires that swaps that are subject to the mandatory clearing requirement under new CEA Section 2(h)(1) must be executed on either a designated contract market or a swap execution facility. Section 2(h)(8)(B) provides an exception to the Trade Execution Requirement if the swap is subject to the commercial end-user exception to the clearing requirement in CEA Section 2(h)(7), or if no contract market or swap execution facility "makes the swap available to trade." This provision was included in the bill as reported by the Senate Agriculture Committee and then in the bill that was passed by the Senate.

In interpreting the phrase "makes the swap available to trade," it is intended that the CFTC should take a practical rather than a formal or legalistic approach. Thus, in determining whether a swap execution facility "makes the swap available to trade," the CFTC should evaluate not just whether the swap execution facility permits the swap to be traded on the facility, or identifies the swap as a candidate for trading on the facility, but also whether, as a practical matter, it is in fact possible to trade the swap on the facility. The CFTC could consider, for example, whether there is a minimum amount of liquidity such that the swap can actually be traded on the facility. The mere "listing" of the swap by a swap execution facility, in and of itself, without a minimum amount of liquidity to make trading possible, should not be sufficient to trigger the Trade Execution Requirement.

Both Section 723 and Section 729 establish requirements pertaining to the reporting of pre-enactment and post-enactment swaps to swap data repositories or the CFTC. They do so in new Sections 2(h)(5) and 4r(a) of the Commodity Exchange Act, respectively, which provide generally that swaps must be reported pursuant to such rules or regulations as the CFTC prescribes. These provisions should be interpreted as complementary to one another and to assure consistency between them. This is particularly true with respect to issues such as the effective dates of these reporting requirements, the applicability of these provisions to cleared and/or uncleared swaps, and their applicability—or non-applicability—to swaps whose terms have expired at the date of enactment.

Section 724 creates a segregation and bankruptcy regime for cleared swaps that is intended to parallel the regime that currently exists for futures. Section 724 requires any person holding customer positions in cleared swaps at a derivatives clearing organization to be registered as an FCM with the CFTC. Section 724 does not require, and there is no intention to require, swap dealers, major swap participants, or end users to register as FCMs with the CFTC to the extent that such entities hold collateral or margin which has been put up by a counterparty of theirs in connection with a swap transaction. In amending both the Commodity Exchange Act (CEA) and the Bankruptcy Code to clarify that cleared swaps are "commodity contracts," Section 724 makes explicit what had been left implicit under the Commodity Futures Modernization Act of 2000. Specifically, we have clarified that: 1) title 11, Chapter 7, Subchapter IV of the United States Bankruptcy Code applies to cleared swaps to the same extent that it applies to futures; and 2) the CFTC has the same authority under Section 20 of the CEA to interpret such provisions of the Bankruptcy Code with respect to cleared swaps as it has with respect to futures contracts.

Section 731 prohibits a swap dealer or major swap participant from permitting any associated person who is subject to a statutory disqualification under the Commodity Exchange Act (CEA) to effect or be involved in effecting swaps on its behalf, if it knew or reasonably should have known of the statutory disqualification. In order to implement this statutory disqualification provision, the CFTC may require such associated persons to register with the CFTC under such terms, and subject to such exceptions, as the CFTC deems appropriate.

The term "associated person of a swap dealer or major swap participant" is defined in

Section 721 as a person who, among other things, is involved in the "solicitation" or "acceptance" of swaps. These terms would also include the negotiation of swaps.

Section 731 includes a new Section 4s(g) of the CEA to impose requirements regarding the maintenance of daily trading records on swap dealers and major swap participants. To reflect advances in technology, CEA Section 4s(g) expressly requires that these registrants maintain "recorded communications, including electronic mail, instant messages, and recordings of telephone calls." Under current law, Section 4g of the CEA governs the maintenance of daily trading records by certain existing classes of CFTC registrants, and is worded more generally and without expressly mentioning the recorded communications enumerated in CEA Section 4s(g). The enactment of this provision should not be interpreted to mean or imply that the specifically-identified types of recorded communications that must be maintained by swap dealers and major swap participants under CEA Section 4s(g) would be beyond the authority of the CFTC to require of other registrants by rule under Section 4g.

Sections 733 and 735 establish a regime of core principles to govern the operations of swap execution facilities and designated contract markets, respectively. Certain of these swap execution facility and designated contract market core principles are identically worded. Given that swap execution facilities will trade swaps exclusively, whereas designated contract markets will be able to trade swaps or futures contracts, we expect that the CFTC may interpret identically-worded core principles differently where they apply to different types of instruments or for different types of trading facilities or platforms.

Section 737 amends Section 4a(a)(1) of the Commodity Exchange Act (CEA) to authorize the CFTC to establish position limits for "swaps that perform or affect a significant price discovery function with respect to registered entities." Subsequent descriptions of the significant price discovery function concept in Section 737, though, refer to an impact on "regulated markets" or "regulated entities." The term "registered entity" is specifically defined in the CEA, and clearly includes designated contract markets and swap execution facilities. By contrast, the terms "regulated markets" and "regulated entities" are not defined or used anywhere else in the CEA. This different terminology is not intended to suggest a substantive difference, and it is expected that the CFTC may interpret the terms "regulated markets" and "regulated entities" to mean "registered entities" as defined in the statute for purposes of position limits under Section 737.

Section 737 also amends CEA Section 4a(a)(1) to authorize the CFTC to establish position limits for "swaps traded on or subject to the rules of a designated contract market or a swap execution facility, or swaps not traded on or subject to the rules of a designated contract market or a swap execution facility that performs a significant price discovery function with respect to a registered entity." Later, Section 737 sets out additional provisions authorizing CFTC position limits to reach swaps, but without utilizing this same wording regarding swaps traded on or off designated contract markets or swap execution facilities. The absence of this wording is not intended to preclude the CFTC from applying any of the position limit provisions in Section 737 in the same manner with respect to DCM or SEF traded swaps as is explicitly provided for in CEA Section 4a(a)(1).

Finally, Section 737 amends CEA Section 4a(a)(4) to authorize the CFTC to establish position limits on swaps that perform a significant price discovery function with respect to regulated markets, including price linkage situations where a swap relies on the daily or final settlement price of a contract traded on a regulated market based upon the same underlying commodity. Section 737 also amends CEA Section 4a(a)(5) to provide that the CFTC shall establish position limits on swaps that are "economically equivalent" to futures or options traded on designated contract markets. It is intended that this "economically equivalent" provision reaches swaps that link to a settlement price of a contract on a designated contract market, without the CFTC having to first make a determination that the swaps perform a significant price discovery function.

Section 741, among other things, clarifies that the CFTC's enforcement authority extends to accounts and pooled investment vehicles that are offered for the purpose of trading, or that trade, off-exchange contracts in foreign currency involving retail customers. Thus, the CFTC may bring an enforcement action for fraud in the offer and sale of such managed or pooled foreign currency investments or accounts. These provisions overrule an adverse decision in the CFTC enforcement case of *CFTC v. White Pine Trust Corporation*, 574 F.3d 1219 (9th Cir. 2009), which erected an inappropriate limitation on the broad mandate that Congress has given the CFTC to protect this country's retail customers from fraud.

Section 742 includes several important provisions to enhance the protections afforded to customers in retail commodity transactions, and I would like to highlight three of them. First, Section 742 clarifies the prohibition on off-exchange retail futures contracts that has been at the heart of the Commodity Exchange Act (CEA) throughout its history. In recent years, there have been instances of fraudsters using what are known as "rolling spot contracts" with retail customers in order to evade the CFTC's jurisdiction over futures contracts. These contracts function just like futures, but the court of appeals in the Zelener case (*CFTC v. Zelener*, 373 F.3d 861 (7th Cir. 2004)), based on the wording of the contract documents, held them to be spot contracts outside of CFTC jurisdiction. The CFTC Reauthorization Act of 2008, which was enacted as part of that year's Farm Bill, clarified that such transactions in foreign currency are subject to CFTC anti-fraud authority. It left open the possibility, however, that such Zelener-type contracts could still escape CFTC jurisdiction if used for other commodities such as energy and metals.

Section 742 corrects this by extending the Farm Bill's "Zelener fraud fix" to retail off-exchange transactions in all commodities. Further, a transaction with a retail customer that meets the leverage and other requirements set forth in Section 742 is subject not only to the anti-fraud provisions of CEA Section 4b (which is the case for foreign currency), but also to the on-exchange trading requirement of CEA Section 4(a), "as if" the transaction was a futures contract. As a result, such transactions are unlawful, and may not be intermediated by any person, unless they are conducted on or subject to the rules of a designated contract market subject to the full array of regulatory requirements applicable to on-exchange futures under the CEA. Retail off-exchange transactions in foreign currency will continue to be covered by the "Zelener fraud fix" enacted in the Farm Bill; further, cash or spot contracts, forward contracts, securities, and certain banking products are excluded from this provision in Section 742, just as they were excluded in the Farm Bill.

Second, Section 742 addresses the risk of regulatory arbitrage with respect to retail foreign currency transactions. Under the CEA, several types of regulated entities can provide retail foreign currency trading platforms—among them, broker-dealers, banks, futures commission merchants, and the category of "retail foreign exchange dealers" that was recognized by Congress in the Farm Bill in 2008. Section 742 requires that the agencies regulating these entities have comparable regulations in place before their regulated entities are allowed to offer retail foreign currency trading. This will ensure that all domestic retail foreign currency trading is subject to similar protections.

Finally, Section 742 also addresses a situation where domestic retail foreign currency firms were apparently moving their activities offshore in order to avoid regulations required by the National Futures Association. It removes foreign financial institutions as an acceptable counterparty for off-exchange retail foreign currency transactions under section 2(c) of the CEA. Foreign financial institutions seeking to offer them to retail customers within the United States will now have to offer such contracts through one of the other legal mechanisms available under the CEA for accessing U.S. retail customers.

Section 745 provides that in connection with the listing of a swap for clearing by a derivatives clearing organization, the CFTC shall determine, both the initial eligibility and the continuing qualification of the DCO to clear the swap under criteria determined by the CFTC, including the financial integrity of the DCO. Thus, the CFTC has the flexibility to impose terns or conditions that it determines to be appropriate with regard to swaps that a DCO plans to accept for clearing. No DCO may clear a swap absent a determination by the CFTC that the DCO has proper risk management processes in place and that the DCO's clearing operation is in accordance with the Commodity Exchange Act and the CFTC's regulations thereunder.

Section 753 adds a new anti-manipulation provision to the Commodity Exchange Act (CEA) addressing fraud-based manipulation, including manipulation by false reporting. Importantly, this new enforcement authority being provided to the CFTC supplements, and does not supplant, its existing anti-manipulation authority for other types of manipulative conduct. Nor does it negate or undermine any of the case law that has developed construing the CEA's existing anti-manipulation provisions.

The good faith mistake provision in Section 753 is an affirmative defense. The burden of proof is on the person asserting the good faith mistake defense to show that he or she did not know or act in reckless disregard of the fact that the report was false, misleading, or inaccurate.

Section 753 also re-formats CEA Section 6(c), which is where the new anti-manipulation authority is placed, to make it easier for courts and the public to use and understand. Changes made to existing text as part of this re-formatting were made to streamline or eliminate redundancies, not to effect substantive changes to these provisions.

Title VIII of the legislation provides enhanced authorities and procedures for those clearing organizations and activities of financial institutions that have been designated as systemically important by a super-majority of the new Financial Stability Oversight Council. Title VIII preserves the authority of the CFTC and SEC as primary regulators of clearinghouses and clearing activities within their jurisdiction. Title VIII further expands the CFTC's and SEC's authorities in prescribing risk management standards and other regulations to govern designated clearing entities, and financial institutions engaged in designated activities. Similarly, Title VIII preserves and expands the CFTC's and SEC's examination and enforcement authorities with respect to designated entities within their respective jurisdictions.

Title VIII sets forth specific standards and procedures that permit the Council, upon a supermajority vote of the Council, and upon a determination that additional risk management standards are necessary to prevent significant risks to the stability of the financial system, to require the CFTC or SEC to impose additional risk management standards regarding designated financial market utilities or financial institutions engaged in designated activities.

Thus, the authorities granted in Title VIII are intended to be both additive and complementary to the authorities granted to the CFTC and SEC in Title VII and to those agencies' already existing legal authorities. The authority provided in Title VIII to the CFTC and SEC with respect to designated clearing entities and financial institutions engaged in designated activities would not and is not intended to displace the CFTC's and SEC's regulatory regime that would apply to these institutions or activities.

Whereas Title VIII is specifically addressed to payment, settlement, and clearing activities, Title I is addressed to consolidated entity supervision of complex financial institutions. Accordingly, to prevent coverage under two separate regulatory schemes, clearing agencies and derivatives clearing organizations are generally excepted from Title I. Also excepted from Title I are national exchanges, designated contract markets, swap execution facilities and other enumerated entities.

Title X of the legislation, which establishes a new Bureau of Consumer Financial Protection, maintains the supervisory, enforcement, rulemaking and other authorities of the CFTC over the persons it regulates. The legislation expressly prohibits the new Bureau from exercising any powers with respect to any persons regulated by the CFTC, to the extent that the actions of those persons are subject to the jurisdiction of the CFTC. It is not intended that Title X would lead to overlapping supervision of such persons by the Bureau. In this respect, the legislation is fully consistent with the Treasury Department's White Paper on Financial Regulatory Reform, which proposed the creation of an agency "dedicated to protecting consumers in the financial products and services markets, except for investment products and services already regulated by the SEC or CFTC." (See Treasury White Paper at 55-56 (June 17, 2009) (emphasis added)).

Senators Lincoln and Dodd – Section 716

FOREIGN BANKS

Mrs. LINCOLN. Mr. President, I wish to engage my colleague, Senator Dodd, in a brief colloquy related to the section 716, the bank swap desk provision.

In the rush to complete the conference, there was a significant oversight made in finalizing section 716 as it relates to the treatment of uninsured U.S. branches and agencies of foreign banks. Under the U.S. policy of national treatment, which has been part of U.S. law since the International Banking Act of 1978, uninsured U.S. branches and agencies of foreign banks are authorized to engage in the same activities as insured depository institutions. While these U.S. branches and agencies of foreign banks do not have deposits insured by the FDIC, they are registered and regulated by a Federal banking regulator, they have access to the Federal Reserve discount window, and other Federal Reserve credit facilities.

It is my understanding that a number of these U.S. branches and agencies of foreign banks will be swap entities under section 716 and title VII of Dodd-Frank. Due to the fact that the section 716 safe harbor only applies to "insured depository institutions" it means that U.S. branches and agencies of foreign banks will be forced to push out all their swaps activities. This result was not intended. U.S. branches and agencies of foreign banks should be subject to the same swap desk push out requirements as insured depository institutions under section 716. Under section 716, insured depository institutions must push out all swaps and security-based swaps activities except for specifically enumerated activities, such as hedging and other similar risk mitigating activities directly related to the insured depository institution's activities, acting as a swaps entity for swaps or security-based swaps that are permissible for investment, and acting as a swaps entity for cleared credit default swaps. U.S. branches and agencies of foreign banks should, and are willing to, meet the push out requirements of section 716 as if they were insured depository institutions.

This oversight on our part is unfortunate and clearly unintended. Does my colleague agree with me about the need to include uninsured U.S. branches and agencies of foreign banks in the safe harbor of section 716?

Mr. DODD. Mr. President, I agree completely with Senator Lincoln's analysis and with the need to address this issue to ensure that uninsured U.S. branches and agencies of foreign banks are treated the same as insured depository institutions under the provisions of section 716, including the safe harbor language.

END USERS

Mrs. LINCOLN. Mr. President, I will ask unanimous consent to have printed in the Record a letter that Chairman Dodd and I wrote to Chairmen Frank and Peterson during House consideration of this Conference Report regarding the derivatives title. The letter emphasizes congressional intent regarding commercial end users who enter into swaps contracts.

As we point out, it is clear in this legislation that the regulators only have the authority to set capital and margin requirements on swap dealers and major swap participants for uncleared swaps, not on end users who qualify for the exemption from mandatory clearing.

As the letter also makes clear, it is our intent that the any margin required by the regulators will be risk-based, keeping with the standards we have put into the bill regarding capital. It is in the interest of the financial system and end user counterparties that swap dealers and major swap participants are sufficiently capitalized. At the same time, Congress did not mandate that regulators set a specific margin level. Instead, we granted a broad authority to the regulators to set margin. Again, margin and capital standards must be risk-based and not be punitive.

It is also important to note that few end users will be major swap participants, as we have excluded "positions held for hedging or mitigating commercial risk" from being considered as a "substantial position" under that definition. I would ask Chairman Dodd whether he concurs with my view of the bill.

Mr. DODD. I agree with the Chairman's assessment. There is no authority to set margin on end users, only major swap participants and swap dealers. It is also the intent of this bill to distinguish between commercial end users hedging their risk and larger, riskier market participants. Regulators should distinguish between these types of companies when implementing new regulatory requirements.

Mrs. LINCOLN. Mr. President, I ask unanimous consent to have printed in the Record the letter that Chairman Dodd and I wrote to Chairmen Frank and Peterson to which I referred.

INVESTMENT ADVISER

Mrs. LINCOLN. Mr. President, I rise to discuss section 409 of the Dodd-Frank bill, which excludes family offices from the definition of investment adviser under the Investment Advisers Act. In section 409, the SEC is directed to define the term family offices and to provide exemptions that recognize the range of organizational, management, and employment structures and arrangement employed by family offices, and I thought it would be worthwhile to provide guidance on this provision.

For many decades, family offices have managed money for members of individual families, and they do not pose systemic risk or any other regulatory issues. The SEC has provided exemptive relief to some family offices in the past, but many family offices have simply relied on the "under 15 clients" exception to the Investment Advisers Act, and when Congress eliminated this exception, it was not our intent to include family offices in the bill.

The bill provides specific direction for the SEC in its rulemaking to recognize that most family offices often have officers, directors, and employees who may not be family members, and who are employed by the family office itself or affiliated entities owned, directly or indirectly, by the family members. Often, such persons co-invest with family members, which enable those persons to share in the profits of investments they oversee and better align the interests of those persons with those of the family members served by the family office. In addition, family offices may have a small number of co-investors such as persons who help identify investment opportunities, provide professional advice, or manage portfolio companies.

However, the value of investments by such other persons should not exceed a de minimis percentage of the total value of the assets managed by the family office. Accordingly, section 409 directs the SEC not to exclude a family office from the definition by reason of its providing investment advice to these persons.

Mr. DODD. I thank the Senator. Pursuant to negotiations during the conference committee, it was my desire that the SEC write rules to exempt certain family offices already in operation from the definition of investment adviser, regardless of whether they had previously received an SEC exemptive order. It was my intent that the rule would: exempt family offices, provided that they operated in a manner consistent with the previous exemptive policy of the Commission as reflected in exemptive orders for family offices in effect on the date of enactment of the Dodd-Frank Act; reflect a recognition of the range of organizational, management and employment structures and arrangements employed by family offices; and not exclude any person who was not registered or required to be registered under the Advisers Act from the definition of the term "family office" solely because such person provides investment advice to natural persons who, at the time of their applicable investment, are officers, directors or employees of the family office who have previously invested with the family office and are accredited investors, any company owned exclusively by such officers, directors or employees or their successors-in-interest and controlled by the family office, or any other natural persons who identify investment opportunities to the family office and invest in such transactions on substantially the same terms as the family office invests, but do not invest in other funds advised by the family office, and whose assets to which the family office provides investment advice represent, in the aggregate, not more than 5 percent of the total assets as to which the family office provides investment advice.

Mrs. LINCOLN. I appreciate the Senator's explanation and ask that the Senator work with me to make this point in a technical corrections bill.

Mr. DODD. I agree that this position should be raised in a corrections bill and I look forward to working with the Senator towards this goal on this point.

Mrs. LINCOLN. I thank the Senator for his leadership and his assistance and cooperation in ensuring the passage of this important bill.

Senators Lincoln and Harkin – Sections 731 and 764

INDEPENDENT REPRESENTATIVES

Mrs. LINCOLN. Mr. President, as chairman of the Agriculture, Nutrition, and Forestry Committee, I became acutely aware that our pension plans, governmental investors, and charitable endowments were falling victim to swap dealers marketing swaps and security-based swaps that they knew or should have known to be inappropriate or unsuitable for their clients. Jefferson County, AL, is probably the most infamous example, but there are many others in Pennsylvania and across the country. That is why I worked with Senator *Harkin* and our colleagues in the House to include protections for pension funds, governmental entities, and charitable endowments in the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Those protections—set forth in section 731 and section 764 of the conference report—place certain duties and obligations on swap dealers and security-based swap dealers when they deal with special entities. One of those obligations is that a swap dealer or the security-based swap dealer entering into a swap or security-based swap with a special entity must have a reasonable basis for believing that the special entity has an independent representative evaluating the transaction. Our intention in imposing the independent representative requirement was to ensure that there was always someone independent of the swap dealer or the security-based swap dealer reviewing and approving swap or security-based swap transactions. However, we did not intend to require that the special entity hire an investment manager independent of the special entity. Is that your understanding, Senator Harkin?

Mr. HARKIN. Yes, that is correct. We certainly understand that many special entities have internal managers that may meet the independent representative requirement. For example, many public electric and gas systems have employees whose job is to handle the day-to-day hedging operations of the system, and we intended to allow them to continue to rely on those in-house managers to evaluate and approve swap and security-based swap transactions, provided that the manager remained independent of the swap dealer or the security-based swap dealer and met the other conditions of the provision. Similarly, the named fiduciary or in-house asset manager—INHAM—for a pension plan may continue to approve swap and security-based swap transactions.

Senator Feinstein – Event Contracts

Mrs. FEINSTEIN. I thank Chairman *Lincoln* and Chairman *Dodd* for maintaining section 745 in the conference report accompanying the Dodd-Frank Wall Street Reform and Consumer Protection Act, which gives authority to the Commodity Futures Trading Commission to prevent the trading of futures and swaps contracts that are contrary to the public interest.

Mrs. LINCOLN. Chairman *Dodd* and I maintained this provision in the conference report to assure that the Commission has the power to prevent the creation of futures and swaps markets that would allow citizens to profit from devastating events and also prevent gambling through futures markets. I thank the Senator from California for encouraging Chairman *Dodd* and me to include it. I agree that this provision will strengthen the government's ability to protect the public interest from gaming contracts and other events contracts.

Mrs. FEINSTEIN. It is very important to restore CFTC's authority to prevent trading that is contrary to the public interest. As you know, the Commodity Exchange Act required CFTC to prevent trading in futures contracts that were "contrary to the public interest" from 1974 to 2000. But the Commodity Futures Modernization Act of 2000 stripped the CFTC of this authority, at the urging of industry. Since 2000, derivatives traders have bet billions of dollars on derivatives contracts that served no commercial purpose at all and often threaten the public interest.

I am glad the Senator is restoring this authority to the CFTC. I hope it was the Senator's intent, as the author of this provision, to define "public interest" broadly so that the CFTC may consider the extent to which a proposed derivative contract would be used predominantly by speculators or participants not having a commercial or hedging interest. Will CFTC have the power to determine that a contract is a gaming contract if the predominant use of the contract is speculative as opposed to a hedging or economic use?

Mrs. LINCOLN. That is our intent. The Commission needs the power to, and should, prevent derivatives contracts that are contrary to the public interest because they exist predominantly to enable gambling through supposed "event contracts." It would be quite easy to construct an "event contract" around sporting events such as the Super Bowl, the Kentucky Derby, and Masters Golf Tournament. These types of contracts would not serve any real commercial purpose. Rather, they would be used solely for gambling.

Mrs. FEINSTEIN. And does the Senator agree that this provision will also empower the Commission to prevent trading in contracts that may serve a limited commercial function but threaten the public good by allowing some to profit from events that threaten our national security?

Mrs. LINCOLN. I do. National security threats, such as a terrorist attack, war, or hijacking pose a real commercial risk to many businesses in America, but a futures contract that allowed people to hedge that risk would also involve betting on the likelihood of events that threaten our national security. That would be contrary to the public interest.

Mrs. FEINSTEIN. I thank the Senator for including this provision. No one should profit by speculating on the likelihood of a terrorist attack. Firms facing financial risk posed by threats to our national security may take out insurance, but they should not buy a derivative. A futures market is for hedging. It is not an insurance market.

Senator Stabenow – Captive Finance

Ms. STABENOW. Mr. President, I would like to discuss the derivatives title of the Wall Street reform legislation with chairman of the Senate Agriculture, Nutrition, and Forestry Committee, Senator Lincoln.

I would like to first commend the Senator and her staff's hard work on this critically important bill, which brings accountability, transparency, and oversight to the opaque derivatives market.

For too long the over-the-counter derivatives market has been unregulated, transferring risk between firms and creating a web of fragility in a system where entities became too interconnected to fail.

It is clear that unregulated derivative markets contributed to the financial crisis that crippled middle-class families. Small businesses and our manufacturers couldn't get the credit they needed to keep the lights on, and many had to close their doors permanently. People who had saved money and played by the rules lost $1.6 trillion from their retirement accounts. More than 6 million families lost their homes to foreclosure. And before the recession was over, more than 7 million Americans had lost their jobs.

The status quo is clearly not an option.

The conference between the Senate and the House produced a strong bill that will make sure these markets are accountable and fair and that the consumers are back in control.

I particularly want to thank the Senator for her efforts to protect manufacturers that use derivatives to manage risks associated with their operations. Whether it is hedging the risks related to fluctuating oil prices or foreign currency revenues, the ability to provide financial certainty to companies' balance sheets is critical to their viability and global competitiveness.

I am glad that the conference recognizes the distinction between entities that are using the derivatives market to engage in speculative trading and our manufacturers and businesses that are not speculating. Instead, they use this market responsibly to hedge legitimate business risk in order to reduce volatility and protect their plans to make investments and create jobs.

Is it the Senator's understanding that manufacturers and companies that are using derivatives to hedge legitimate business risk and do not engage in speculative behavior will not be subjected to the capital or margin requirements in the bill?

Mrs. LINCOLN. I thank the Senator for her efforts to protect manufacturers. I share the Senator's concerns, which is why our language preserves the ability of manufacturers and businesses to use derivatives to hedge legitimate business risk.

Working closely with the Senator, I believe the legislation reflects our intent by providing a clear and narrow end-user exemption from clearing and margin requirements for derivatives held by companies that are not major swap participants and do not engage in speculation but use these products solely as a risk-management tool to hedge or mitigate commercial risks.

Ms. STABENOW. Again, I appreciate the Senator's efforts to work with me on language that ensures manufacturers are not forced to unnecessarily divert working capital from core business activities, such as investing in new equipment and creating more jobs. As you know, large manufacturers of high-cost products often establish wholly owned captive finance affiliates to support the sales of its products by providing financing to customers and dealers.

Captive finance affiliates of manufacturing companies play an integral role in keeping the parent company's plants running and new products moving. This role is even more important during down□turns and in times of limited market liquidity. As an example, Ford's captive finance affiliate, Ford Credit, continued to consistently support over 3,000 of Ford's dealers and Ford Credit's portfolio of more than 3 million retail customers during the recent financial crisis—at a time when banks had almost completely withdrawn from auto lending.

Many finance arms securitize their loans through wholly owned affiliate entities, thereby raising the funds they need to keep lending. Derivatives are integral to the securitization funding process and consequently facilitating the necessary financing for the purchase of the manufacturer's products.

If captive finance affiliates of manufacturing companies are forced to post margin to a clearinghouse it will divert a significant amount of capital out of the U.S. manufacturing sector and could endanger the recovery of credit markets on which manufacturers and their captive finance affiliates depend.

Is it the Senator's understanding that this legislation recognizes the unique role that captive finance companies play in supporting manufacturers by exempting transactions entered into by such companies and their affiliate entities from clearing and margin so long as they are engaged in financing that facilitates the purchase or lease of their commercial end user parents products and these swaps contracts are used for non-speculative hedging?

Mrs. LINCOLN. Yes, this legislation recognizes that captive finance companies support the jobs and investments of their parent company. It would ensure that clearing and margin requirements would not be applied to captive finance or affiliate company transactions that are used for legitimate, nonspeculative hedging of commercial risk arising from supporting their parent company's operations. All swap trades, even those which are not cleared, would still be reported to regulators, a swap data repository, and subject to the public reporting requirements under the legislation.

This bill also ensures that these exemptions are tailored and narrow to ensure that financial institutions do not alter behavior to exploit these legitimate exemptions.

Based on the Senator's hard work and interest in captive finance entities of manufacturing companies, I would like to discuss briefly the two captive finance provisions in the legislation and how they work together. The first captive finance provision is found in section 2(h)(7) of the CEA, the "treatment of affiliates" provision in the end-user clearing exemption and is entitled "transition rule for affiliates." This provision is available to captive finance entities which are predominantly engaged in financing the purchase of products made by its parent or an affiliate. The provision permits the captive finance entity to use the clearing exemption for not less than two years after the date of enactment. The exact transition period for this provision will be subject to rulemaking. The second captive finance provision differs in two important ways from the first provision. The second captive finance provision does not expire after 2 years. The second provision is a permanent exclusion from the definition of "financial entity" for those captive finance entities who use derivatives to hedge commercial risks 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company. It is also limited to the captive finance entity's use of interest rate swaps and foreign exchange swaps. The second captive finance provision is also found in Section 2(h)(7) of the CEA at the end of the definition of "financial entity." Together, these 2 provisions provide the captive finance entities of manufacturing companies with significant relief which will assist in job creation and investment by our manufacturing companies.

Ms. STABENOW. I agree that the integrity of these exemptions is critical to the reforms enacted in this bill and to the safety of our financial system. That is why I support the strong anti-abuse provisions included in the bill.

Would you please explain the safeguards included in this bill to prevent abuse?

Mrs. LINCOLN. It is also critical to ensure that we only exempt those transactions that are used to hedge by manufacturers, commercial entities and a limited number of financial entities. We were surgical in our approach to a clearing exemption, making it as narrow as possible and excluding speculators.

In addition to a narrow end-user exemption, this bill empowers regulators to take action against manipulation. Also, the Commodity Futures Trading Commission and the Securities Exchange Commission will have a broad authority to write and enforce rules to prevent abuse and to go after anyone that attempts to circumvent regulation.

America's consumers and businesses deserve strong derivatives reform that will ensure that the country's financial oversight system promotes and fosters the most honest, open and reliable financial markets in the world.

Ms. STABENOW. I thank the Chairman for this opportunity to clarify some of the provisions in this bill. I appreciate the Senator's help to ensure that this bill recognizes that manufacturers and commercial entities were victims of this financial crisis, not the cause, and that it does not unfairly penalize them for using these products as part of a risk-mitigation strategy.

It is time we shine a light on derivatives trading and bring transparency and fairness to this market, not just for the families and businesses that were taken advantage of but also for the long-term health of our economy and particularly our manufacturers.

Senator Collins – Swap Dealer Provisions

Ms. COLLINS. Mr. President, I rise today as a supporter of the Wall Street Transparency and Accountability Act, but also as one who has concerns over how the derivatives title of the bill will be implemented. I applaud the chairman of the Senate Banking Committee for his work on the underlying bill. At the same time, I am concerned that some of the provisions in the derivatives title will harm U.S. businesses unnecessarily.

I would like to engage the chairman of the Senate Banking Committee in a colloquy that addresses an important issue. The Wall Street Transparency and Accountability Act will regulate "swap dealers" for the first time by subjecting them to new clearing, capital and margin requirements. "Swap dealers" are banks and other financial institutions that hold themselves out to the derivatives market and are known as dealers or market makers in swaps. The definition of a swap dealer in the bill includes an entity that "regularly enters into swaps with counter-parties as an ordinary course of business for its own account." It is possible the definition could be read broadly and include end users that execute swaps through an affiliate. I want to make clear that it is not Congress' intention to capture as swap dealers end users that primarily enter into swaps to manage their business risks, including risks among affiliates.

I would ask the distinguished chairman whether he agrees that end users that execute swaps through an affiliate should not be deemed to be "swap dealers" under the bill just because they hedge their risks through affiliates.

Mr. DODD. I do agree and thank my colleague for raising another important point of clarification. I believe the bill is clear that an end user does not become a swap dealer by virtue of using an affiliate to hedge its own commercial risk. Senator Collins has been a champion for end users and it is a pleasure working with her.

Senator Johnson – Preemption and Section 913

Mr. JOHNSON. Madam President, Congress is now on the brink of passing a landmark deal on legislation to reform Wall Street and prevent another financial crisis like the one we faced nearly 2 years ago. This legislation is an important and long overdue measure that will help to safeguard the long-term stability of our economy.

In the closing months of the Bush administration, our Nation faced an economic situation so dire that many feared our financial system was on the verge of collapse. Though we were able to avert such a collapse, the impact of the crisis spread across America, leaving few untouched.

Virtually all of us have been impacted by the economic meltdown in some way: businesses shed jobs, workers' hours were cut, some folks had great difficulty making their mortgage payments when their pay was cut, small businesses lost customers and revenue in the down-turn. South Dakota homeowners, regardless of whether they had a mortgage or owned their home outright, saw their equity drop, and most folks with investments for retirement or other long-term goals suffered losses either through the stock market plunge, bond market turbulence, or passbook savings interest rates that hovered near zero percent. Lending at our Nation's banks contracted, spending fell, and overall consumer confidence plummeted.

Americans were rightly angry that while they were losing their homes, jobs, and long-term savings, they were also expected to foot the bill for the irresponsible actions of Wall Street CEOs. Their outrage only grew when these same CEOs continued collecting unprecedented bonuses—presumably for their work in recklessly taking our Nation to the brink of collapse. Frankly, I share that anger.

It is clear that our economy has not yet fully recovered, but in the last year and a half, Congress has dedicated itself to turning our economy around. We are now on the verge of passing historic legislation that creates better accountability and transparency for Wall Street and the financial sector.

As a senior member of the Banking Committee, and a member of the conference committee, I have worked hard to identify the causes of the crisis and find the right solutions to address these causes. I have talked at length with South Dakotans of all backgrounds and political stripes to gain their perspective, and there are some things that get mentioned time and again: there were many causes for the meltdown, but gaps in regulation contributed to the problem; rules that applied to some financial companies but not all opened loopholes that bad actors could exploit; the lack of a system to monitor risks across the banking sector left taxpayers vulnerable; regulators were not very focused on looking out for consumers; and large Wall Street firms operated with little or no accountability to either their shareholders or their customers. In addition, it became clear we needed a system to unwind big financial firms like AIG, Lehman Brothers, and Bear Stearns in an orderly fashion and without taxpayer bailouts. Doing nothing is not an option, and I do not think anyone can say with a straight face that our current system of financial regulation works for America.

While not perfect, the Wall Street reform measure does a great deal to address many of these problems. It creates a mechanism to monitor systemic risk in the financial sector, as well as regulating risky derivatives, credit default swaps and other complicated financial products that were not transparent and had previously gone unregulated. It affords consumers better rules governing the products they use and better information about those products by creating a consumer watchdog agency. Importantly, it also creates a way to unwind large financial firms without having to bail them out.

Specifically, I want to mention two provisions. First, I am pleased that the conference committee accepted the Carper-Bayh-Warner-Johnson amendment, which I strongly supported, regarding the preemption standard for State consumer financial laws. This amendment received strong bipartisan support on the Senate floor and passed by a vote of 80 to 18. One change made by the conference committee was to restate the preemption standard in a slightly different way, but it is clear that this legislation is codifying the preemption standard expressed by the U.S. Supreme Court in *Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner*, 517 U.S. 25 (1996) case. This will provide certainty to consumers and those that offer consumers financial products.

Also, section 913 of the conference report reflects a compromise between the House and Senate provisions on the standard of care for brokers, dealers, and investment advisers. It includes the original study provisions passed by the Senate, together with additional areas of study requested by the House—a total of 13 separate considerations and a number of subparts, where we expect the SEC to thoroughly, objectively and without bias evaluate legal and regulatory standards, gaps, shortcomings and overlaps. We expect the SEC to conduct the study without prejudging its findings, conclusions, and recommendations and to solicit and consider public comment, as the statute requires. As Chairman *Frank* described the compromise when he presented it to the committee, section 913 does not immediately impose any new duties on brokers, dealers and investment advisers nor does it mandate any particular duty or outcome, but it gives the SEC, subsequent to the conclusion of the study, the authority to conduct a rulemaking on the standard of care, including the authority to impose a fiduciary duty. I think this is a strong compromise between the House and Senate positions.

This bill gives financial institutions, regulators and consumers the right tools to make good decisions, and it also provides the right tools to prevent another crisis like the one we recently experienced. Many of the bill's provisions, including those mentioned previously, have bipartisan support; in fact, many of the core ideas incorporated into the bill originated from my Republican colleagues.

Critics of this legislation have said that it tackles the wrong problems, hurts small banks and businesses, and burdens struggling financial institutions. I appreciate those points of view, but feel very confident in saying we have taken specific steps to ensure that small banks and businesses are not negatively affected, to make it more difficult for firms to take dangerous risks, and to strike the right balance between regulation and flexibility. But the bottom line is this: the kind of free-wheeling, self-regulating, anything goes environment that we had before the crisis is simply not an option.

There are certainly provisions in this bill that I would have written differently as any of my colleagues would if we wrote this legislation ourselves. But that is not how the Senate and our legislative system works, and overall I think this conference report is very strong legislation. I look forward to its passage.

There is no doubt that after the President signs this bill into law, there will be an important focus on implementing this legislation correctly, as well as continued oversight by Congress of the agencies and covered financial institutions, and efforts at international coordination with our counterparts in other countries. It is also likely that there may need to be corrections and adjustments to the bill in the future. That said, passage of this bill is important to our nation's economic recovery, and we must get it to the President's desk.

Senator Harkin – Stable Value Funds

Mr. HARKIN. Mr. President, as chairman of the Health, Education, Labor, and Pensions Committee, the pensions community approached me about a possible unintended consequence of the derivatives title of the Dodd-Frank Wall Street Reform and Consumer Protection Act. They were concerned that the provisions regulating swaps might also apply to stable value funds.

Stable value funds are a popular, conservative investment choice for many employee benefit plans because they provide a guaranteed rate of return. As I understand it, there are about $640 billion invested in stable value funds, and retirees and those approaching retirement often favor those funds to minimize their exposure to market fluctuations. When the derivatives title was put together, I do not think anyone had stable value funds or stable value wrap contracts—some of which could be viewed as swaps—specifically in mind, and I do not think it is clear to any of us what effect this legislation would have on them.

Therefore, I worked with Chairman *Lincoln*, Senator *Leahy*, and Senator *Casey* to develop a proposal to direct the SEC and CFTC to conduct a study—in consultation with DOL, Treasury, and State insurance regulators—to determine whether it is in the public interest to treat stable value funds and wrap contracts like swaps. This provision is intended to apply to all stable value fund and wrap contracts held by employee benefit plans—defined contribution, defined benefit, health, or welfare—subject to any degree of direction provided directly by participants, including benefit payment elections, or by persons who are legally required to act solely in the interest of participants such as trustees.

If the SEC and CFTC determine that it is in the public interest to regulate stable value fund and wrap contracts as swaps, then they would have the power to do so. I think this achieves the policy goals underlying the derivatives title while still making sure that we don't cause unintended harm to people's pension plans.

Mrs. LINCOLN. Mr. President, I share Chairman *Harkin*'s concern about possible unintended consequences the Dodd-Frank Wall Street Reform and Consumer Protection Act could have on pension and welfare plans which provide their participant with stable value fund options. These stable value fund options and their contract wrappers could be viewed as being a swap or a security-based swap. As Chairman *Harkin* has stated, there is a significant amount of retirement savings in stable value funds, $640 billion, which represents the retirement funds of millions of hardworking Americans. One of my major goals in this legislation was to protect Main Street. We should try to avoid doing any harm to pension plan beneficiaries. When the stable value fund issue was brought to my attention, I knew it was something we had to address. That is why I worked with Chairman *Harkin* and Senators *Leahy* and *Casey* to craft a provision that would give the CFTC and the SEC time to study the issue of whether the stable value fund options and/or the contract wrappers for these stable value funds are "swaps" or some other type of financial instrument such as an insurance contract. I think subjecting this issue to further study will provide a measure of stability to participants and beneficiaries in employee benefit plans—including those participants in defined benefit pension plans, 401(k) plans, annuity plans, supplemental retirement plans, 457 plans, 403(b) plans, and voluntary employee beneficiary associations—while allowing the CFTC and SEC to make an informed decision about what the stable value fund options and their contract wrappers are and whether they should be regulated as swaps or security-based swaps. It is a commonsense solution, and I am proud we were able to address this important issue which could affect the retirement funds of millions of pension beneficiaries.

Senator Hagan – Collateralized Investments

Mrs. HAGAN. Mr. President, I would like to engage Senator Lincoln, chairman of the Agriculture, Nutrition and Forestry Committee, in a colloquy.

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which Chairman *Lincoln* was the primary architect of, creates a new regulatory framework for the over-the-counter derivatives market. It will require a significant portion of derivatives trades to be cleared through a centralized clearinghouse and traded on an exchange, and it will also increase reporting and capital and margin requirements on significant players in the market. The new regulatory framework will help improve transparency and disclosure within the derivatives market for the benefit of all investors.

Under the bill, the Commodity Futures Trading Commission, CFTC, and the Securities and Exchange Commission, SEC, are instructed to further define the terms "major swap participant" and "major security-based swap participant." The definitions of major swap participant and major security-based swap participant included in the bill require the CFTC and the SEC to determine whether a person dealing in swaps maintains a "substantial position" in swaps, as well as whether such outstanding swaps create "substantial counterparty exposure" that could have "serious adverse effects on the financial stability of the United States banking system or financial markets." The definition also encompasses "financial entities" that are highly leveraged relative to the amount of capital it holds, are not already subject to capital requirements set by a Federal banking regulator, and maintain a substantial position in outstanding swaps.

I understand when the CFTC and SEC are making the determination as to whether a person dealing in swaps is a major swap participant or major security-based swap participant, it is the intent of the conference committee that both the CFTC and the SEC focus on risk factors that contributed to the recent financial crisis, such as excessive leverage, under-collateralization of swap positions, and a lack of information about the aggregate size of positions. Is this correct?

Mrs. LINCOLN. Yes. My good friend from North Carolina is correct. We made some important changes during the conference with respect to the "major swap participant" and "major security-based swap participant" definitions. When determining whether a person has a "substantial position," the CFTC and the SEC should consider the person's relative position in cleared versus the uncleared swaps and may take into account the value and quality of the collateral held against counterparty exposures. The committee wanted to make it clear that the regulators should distinguish between cleared and uncleared swap positions when defining what a "substantial position" would be. Similarly where a person has uncleared swaps, the regulators should consider the value and quality of such collateral when defining "substantial position." Bilateral collateralization and proper segregation substantially reduces the potential for adverse effects on the stability of the market. Entities that are not excessively leveraged and have taken the necessary steps to segregate and fully collateralize swap positions on a bilateral basis with their counterparties should be viewed differently.

In addition, it may be appropriate for the CFTC and the SEC to consider the nature and current regulation of the entity when designating an entity a major swap participant or a major security-based swap participant. For instance, entities such as registered investment companies and employee benefit plans are already subject to extensive regulation relating to their usage of swaps under other titles of the U.S. Code. They typically post collateral, are not overly leveraged, and may not pose the same types of risks as unregulated major swap participants.

Mrs. HAGAN. I thank the Senator. If I may, I have one additional question. When considering whether an entity maintains a substantial position in swaps, should the CFTC and the SEC look at the aggregate positions of funds managed by asset managers or at the individual fund level?

Mrs. LINCOLN. As a general rule, the CFTC and the SEC should look at each entity on an individual basis when determining its status as a major swap participant.

Senator Durbin – Interchange Fees

Mr. DURBIN. Mr. President, I rise to speak about my interchange fee amendment that was incorporated into the Dodd-Frank Wall Street Reform and Consumer Protection Act. There are some important aspects of the amendment that I want to clarify for the record.

First, it is important to note that while this amendment will bring much-needed reform to the credit card and debit card industries, in no way should enactment of this amendment be construed as preempting other crucial steps that must be taken to bring competition and fairness to those industries. For example, a key component of the Senate-passed version of my amendment was a provision that would prohibit payment card networks from blocking merchants from offering a discount for customers who use a competing card network. This provision was unfortunately left out of the final conference report, but the need for this provision remains undiminished. It is blatantly anticompetitive for one company to prohibit its customers from offering a discounted price for a competitor's product, and I will continue to pursue steps to end this practice.

Additionally, in no way should my amendment be construed as preempting or superseding scrutiny of the credit card and debit card industries under the antitrust laws. Section 6 of the Dodd-Frank act conference report contains an antitrust savings clause which provides that nothing in the act shall be construed to modify, impair, or supersede the operation of any of the antitrust laws. I want to make clear that nothing in my amendment is intended to modify, impair, or supersede the operation of any of the antitrust laws, nor should my amendment be construed as having that effect. Vigorous antitrust scrutiny over the credit and debit card industries will continue to be needed after enactment of the Dodd-Frank act, particularly in light of the highly concentrated nature of those industries.

With respect to the new subsection 920(a) of the Electronic Fund Transfer Act that would be created by my amendment, there are a few issues that should be clarified. The core provisions of subsection (a) are its grant of regulatory authority to the Federal Reserve Board over debit interchange transaction fees, and its requirement that an interchange transaction fee amount charged or received with respect to an electronic debit transaction be reasonable and proportional to the cost incurred by the issuer with respect to the transaction. Paragraph (a)(4) makes clear that the cost to be considered by the Board in conducting its reasonable and proportional analysis is the incremental cost incurred by the issuer for its role in the authorization, clearance, or settlement of a particular electronic debit transaction, as opposed to other costs incurred by an issuer which are not specific to the authorization, clearance, or settlement of a particular electronic debit transaction.

Paragraph (5) of subsection (a) provides that the Federal Reserve Board may allow for an adjustment of an interchange transaction fee amount received by a particular issuer if the adjustment is reasonably necessary to make allowance for the fraud prevention costs incurred by the issuer seeking the adjustment in relation to its electronic debit transactions, provided that the issuer has demonstrated compliance with fraud-related standards established by the Board. The standards established by the Board will ensure that any adjustments to the fee shall be limited to reasonably necessary costs and shall take into account fraud-related reimbursements that the issuer receives from consumers, merchants, or networks. The standards shall also require issuers that want an adjustment to their interchange fees to take effective steps to reduce the occurrence of and costs from fraud in electronic debit transactions, including through the development of cost-effective fraud prevention technology.

It should be noted that any fraud prevention adjustment to the fee amount would occur after the base calculation of the reasonable and proportional interchange fee amount takes place, and fraud prevention costs would not be considered as part of the incremental issuer costs upon which the reasonable and proportional fee amount is based. Further, any fraud prevention cost adjustment would be made on an issuer-specific basis, as each issuer must individually demonstrate that it complies with the standards established by the Board, and as the adjustment would be limited to what is reasonably necessary to make allowance for fraud prevention costs incurred by that particular issuer. The fraud prevention adjustment provision in paragraph (a)(5) is intended to apply to all electronic debit transactions, whether authorization is based on signature, PIN or other means.

Paragraph (6) of subsection (a) exempts debit card issuers with assets of less than $10 billion from interchange fee regulation. This paragraph makes clear that for purposes of this exemption, the term “issuer” is limited to the person holding the asset account which is debited, and thus does not count the assets of any agents of the issuer. However, the affiliates of an issuer are counted for purposes of the $10 billion exemption threshold, so if an issuer together with its affiliates has assets of greater than $10 billion, then the issuer does not fall within the exemption.

It should be noted that the intent of my amendment is not to diminish competition in the debit issuance market. I will be watching closely to ensure that the giant payment card networks Visa and MasterCard do not collude with one another or with large financial institutions to take steps to purposefully disadvantage small issuers in response to enactment of this amendment.

Paragraph (7) of subsection (a) exempts from interchange fee regulation electronic debit transactions involving debit cards or prepaid cards that are provided to persons as part of a federal, state or local government-administered payment program in which the person uses the card to debit assets provided under the program. The Federal Reserve Board will issue regulations to implement this provision, but it is important to note that this exemption is only intended to apply to cards which can be used to transfer or debit assets that are provided pursuant to the government-administered program. The exemption is not intended to apply to multi-purpose cards that mingle the assets provided pursuant to the government-administered program with other assets, nor is it intended to apply to cards that can be used to debit assets placed into an account by entities that are not participants in the government-administered program.

The amendment would also create subsection 920(b) of the Electronic Fund Transfer Act, which provides several restrictions on payment card networks. Paragraphs (1), (2) and (3) of 920(b) are intended only to serve as restrictions on payment card networks to prohibit them from engaging in certain anticompetitive practices. These provisions are not intended to preclude those who accept cards from engaging in any discounting or other practices, nor should they be construed to preclude contractual arrangements that deal with matters not covered by these provisions. Further, nothing in these provisions should be construed to mean that merchants can only provide a discount that is exactly specified in the amendment. The provisions also should not be read to confer any congressional blessing or approval of any other particular contractual restrictions that payment card networks may place on those who accept cards as payment. All these provisions say is that Federal law now blocks payment card networks from engaging in certain specific enumerated anti-competitive practices, and the provisions describe precisely the boundaries over which payment card networks cannot cross with respect to these specific practices.

Paragraph (b)(1) directs the Federal Reserve Board to prescribe regulations providing that issuers and card networks shall not restrict the number of networks on which an electronic debit transaction may be processed to just one network, or to multiple networks that are all affiliated with each other. It further directs the Board to issue regulations providing that issuers and card networks shall not restrict a person who accepts debit cards from directing the routing of electronic debit transactions for processing over any network that may process the transactions. This paragraph is intended to enable each and every electronic debit transaction—no matter whether that transaction is authorized by a signature, PIN, or otherwise—to be run over at least two unaffiliated networks, and the Board's regulations should ensure that networks or issuers do not try to evade the intent of this amendment by having cards that may run on only two unaffiliated networks where one of those networks is limited and cannot be used for many types of transactions.

Paragraph (b)(2) provides that a payment card network shall not inhibit the ability of any person to provide a discount or in-kind incentive for payment by the use of a particular form of payment—cash, checks, debit cards or credit cards—provided that discounts for debit cards and credit cards do not differentiate on the basis of the issuer or the card network, and provided that the discount is offered in a way that complies with applicable Federal and State laws. This paragraph is in no way intended to preclude the use by merchants of any other types of discounts. It just makes clear that Federal law prohibits payment card networks from inhibiting the offering of discounts which are for a form of payment—for example, a 1-percent discount for payment by debit card. This paragraph also provides that a network may not penalize a person for the way that the person offers or discloses a discount to customers, which will end the current practice whereby payment card networks have regularly sought to penalize merchants for providing cash, check or debit discounts that are fully in compliance with applicable Federal and State laws.

Paragraph (b)(3) provides that a payment card network shall not inhibit the ability of any person to set a minimum dollar value for acceptance of credit cards, provided that the minimum does not differentiate between issuers or card networks, and provided that the minimum does not exceed $10. This paragraph authorizes the Board to increase this dollar amount by regulation. The paragraph also provides that card networks shall not inhibit the ability of a Federal agency or an institution of higher education to set a maximum dollar value for acceptance of credit cards, provided that the maximum does not differentiate between issuers or card networks. As with the discounts, this provision is not intended to preclude merchants, agencies or higher education institutions from setting other types of minimums or maximums by card or amount. It simply makes clear that payment card networks must at least allow for the minimums and maximums described in the provision.

Paragraph (b)(4) contains a rule of construction providing that nothing in this subsection shall be construed to authorize any person to discriminate between debit cards within a card network or to discriminate between credit cards within a card network on the basis of the issuer that issued the card. The intent of this rule of construction is to make clear that nothing in this subsection should be cited by any person as justification for the violation of contractual agreements not to engage in the forms of discrimination cited in this paragraph. This provision does not, however, prohibit such discrimination as a matter of federal law, nor does it make any statement regarding the legality of such discrimination. In addition, this provision makes no statement as to whether a payment card network's contractual rule preventing such discrimination would be legal under the antitrust laws.

Finally, it should be noted that the payment card networks as defined in the amendment are entities such as Visa, MasterCard, Discover, and American Express that directly, or through licensed members, processors or agents, provide the proprietary services, infrastructure and software that route information to conduct credit and debit card transaction authorization, clearance and settlement. The amendment does not intend, for example, to define ATM operators or acquiring banks as payment card networks unless those entities also operate card networks as do Visa, MasterCard, Discover and American Express.

Overall, my amendment contains much needed reforms that will help increase fairness, transparency and competition in the debit card and credit card industries. More work remains to be done along these lines, but this amendment represents an important first step, and I thank my colleagues who have supported this effort.

Senator Collins – Section 603 Trust Companies

SECTION 603 TRUST COMPANIES

Ms. COLLINS. Mr. President, I ask the chairman of the Senate Banking Committee, my colleague from Connecticut, Senator *Dodd*, to clarify the types of trust companies that fall within the scope of section 603(a), a provision that prohibits the Federal Deposit Insurance Corporation from approving an application for deposit insurance for certain companies, including certain trust companies, until 3 years after the date of enactment of this act.

Mr. DODD. I would be glad to clarify the nature of trust companies subject to the moratorium under section 603(a). The moratorium applies to an institution that is directly or indirectly owned or controlled by a commercial firm that functions solely in a trust or fiduciary capacity and is exempt from the definition of a bank in the Bank Holding Company Act. It does not apply to a nondepository trust company that does not have FDIC insurance and that does not offer demand deposit accounts or other deposits that may be withdrawn by check or similar means for payment to third parties.

Ms. COLLINS. I thank my colleague for his clarification.

Senator Carper - Preemption

PREEMPTION STANDARD

Mr. CARPER. Mr. President, I am very pleased to see that the conference committee on the Dodd-Frank Wall Street Reform and Consumer Protection Act retained my amendment regarding the preemption standard for State consumer financial laws with only minor modifications. I very much appreciate the effort of Chairman Dodd in fighting to retain the amendment in conference.

Mr. DODD. I thank the Senator. As the Senator knows, his amendment received strong bipartisan support on the Senate floor and passed by a vote of 80 to 18. It was therefore a Senate priority to retain his provision in our negotiations with the House of Representatives.

Mr. CARPER. One change made by the conference committee was to restate the preemption standard in a slightly different way, but my reading of the language indicates that the conference report still maintains the Barnett standard for determining when a State law is preempted.

Mr. DODD. The Senator is correct. That is why the conference report specifically cites the *Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner*, 517 U.S. 25(1996) case. There should be no doubt that the legislation codifies the preemption standard stated by the U.S. Supreme Court in that case.

Mr. CARPER. I again thank the Senator. This will provide certainty to everyone—those who offer consumers financial products and to consumer themselves.

Senator Nelson – Insurance Companies

INSURANCE COMPANY DEFINITION

Mr. NELSON of Nebraska. Mr. President, first, I would like to commend Chairman *Dodd* for his hard work on the Wall Street reform bill and for maintaining an open and transparent process while developing this legislation. With regard to the orderly liquidation authority under title II of the bill, an "insurance company" is defined in section 201 as any entity that is engaged in the business of insurance, subject to regulation by a State insurance regulator, and covered by a State law that is designed to specifically deal with the rehabilitation, liquidation, or insolvency of an insurance company. Is it the intent of this definition that a mutual insurance holding company organized and operating under State insurance laws should be considered an insurance company for the purpose of this title?

Mr. DODD. Yes, that is correct. It is intended that a mutual insurance holding company organized and operating under State insurance laws should be considered an insurance company for the purpose of title II of this legislation. I thank the Senator from Nebraska for this clarification.

Senator Dodd – General Colloquy

Mr. DODD. Mr. President, I would like to clarify the intent behind one of the provisions in the conference report to accompany the financial reform bill, H.R. 4173, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Section 204(d) contemplates that the FDIC, as receiver, may take a lien on assets of a covered financial company or a covered subsidiary. With respect to assets of a covered subsidiary that is an insurance company or a direct or indirect subsidiary of an insurance company, I believe that the FDIC should exercise such authority cautiously to avoid weakening the insurance company and thereby undermining policyholder protection. Indeed, any lien taken on the assets of a covered subsidiary that is an insurance company or a direct or indirect subsidiary of an insurance company must avoid weakening or undermining policyholder protection. As a result, the FDIC should normally not take a lien on the assets of such a covered subsidiary except where the FDIC sells the covered subsidiary to a third party, provides financing in connection with the sale, and takes a lien on the assets of the covered subsidiary to secure the third party's repayment obligation to the FDIC. I understand that the FDIC intends to promulgate regulations consistent with this view.

Mr. President, I would also like to clarify the intent behind another of the provisions in the conference report to accompany the financial reform bill, H.R. 4173, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Section 1075 of the bill amends the Electronic Fund Transfer Act to create a new section 920 regarding interchange fees. This is a very complicated subject involving many different stakeholders, including payment networks, issuing banks, acquiring banks, merchants, and, of course, consumers. Section 1075 therefore is also complicated, and I would like to make a clarification with regard to that section.

Since interchange revenues are a major source of paying for the administrative costs of prepaid cards used in connection with health care and employee benefits programs such as FSAs, HSAs, HRAs, and qualified transportation accounts—programs which are widely used by both public and private sector employers and which are more expensive to operate given substantiation and other regulatory requirements—we do not wish to interfere with those arrangements in a way that could lead to higher fees being imposed by administrators to make up for lost revenue. That could directly raise health care costs, which would hurt consumers and which, of course, is not at all what we wish to do. Hence, we intend that prepaid cards associated with these types of programs would be exempted within the language of section 920(a)(7)(A)(ii)(II) as well as from the prohibition on use of exclusive networks under section 920(b)(1)(A).

Mr. President, I want to clarify a provision of the conference report of the Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173. Section 1012 sets forth the executive and administrative powers of the Consumer Financial Protection Bureau, CFPB, and section 1012(c)(1)—Coordination with the Board of Governors—provides that "Notwithstanding any other provision of law applicable to the supervision or examination of persons with respect to Federal consumer financial laws, the Board of Governors may delegate to the Bureau the authorities to examine persons subject to the jurisdiction of the Board of Governors for compliance with the Federal consumer financial laws." This provision is not intended to override section 1026, which will continue to define the Bureau's examination and enforcement authority over insured depository institutions and insured credit unions with assets of less than $10 billion. The conferees expect that the board will not delegate to the Bureau its authority to examine insured depository institutions with assets of less than $10 billion.

Throughout the development of and debate on the Consumer Financial Protection Bureau, CFPB, I have insisted that the legislation meet three requirements—independent rule writing, independent examination and enforcement authority, and independent funding for the CFPB. The CFPB, as established by the conference report, meets each of those requirements. I want to speak for a moment about section 1017, which establishes the independent funding mechanism for the CFPB.

The conference report requires the Federal Reserve System to automatically fund the CFPB based on the total operating expenses of the system, using 2009 as the baseline. This will ensure that the CFPB has the resources it needs to perform its functions without subjecting it to annual congressional appropriations. The failure of the Congress to provide the Office of Federal Housing Enterprises Oversight, OFHEO, with a steady stream of independent funding outside the appropriations process led to repeated interference with the operations of that regulator. Even when there was not explicit interference, the threat of congressional interference could very well have served to circumscribe the actions OFHEO was willing to take. We did not want to repeat that mistake in this legislation.

In addition, because many of the employees of the CFPB will come from existing financial regulators, the conferees take the view that it is important that the new entity have the resources to keep these high quality staff and to attract new equally qualified staff, and to provide them with the support that they need to operate effectively. To that end, the conferees adopted the employment cost index for total compensation of State and Federal employees, ECI, as the index by which the funding baseline will be adjusted in the future. This index has generally risen faster than the CPI, which was the index used in the Senate bill. However, the ECI has typically risen at a more gradual rate than the average operating costs of the banking regulators, which was the index proposed by the House conferees.

In the end, the conferees agreed to use the ECI and provide for a contingent authorization of appropriations of $200 million per year through fiscal year 2014. In order to trigger this authorization, the CFPB Director would have to report to the Appropriations Committees that the CFPB's formula funding is not sufficient.

Section 1085 of the legislation adds the Consumer Financial Protection Bureau, CFPB, to the list of agencies authorized to enforce the Equal Credit Opportunity Act, ECOA—15 U.S.C. §1691c(a)(9). The legislation also amends section 706(g)—15 U.S.C. §1691e(g)—to require the CFPB to refer a matter to the Attorney General whenever the CFPB has reason to believe that 1 or more creditors has engaged in a "pattern or practice of discouraging or denying applications for credit" in violation of section 701, 15 U.S.C. §1691(a). The general grant of civil litigation authority to the CFPB, in section 1054(a), should not be construed to override, in any way, the CFPB's referral obligations under the ECOA.

The requirement in section 706(g) of the ECOA that the CFPB refer a matter involving a pattern-or-practice violation of section 701, rather than first filing its own pattern-or-practice action, furthers the legislation's purpose of reducing fragmentation in consumer protection and fair lending enforcement under the ECOA. The Attorney General, who currently has authority under section 706(g) to file those pattern-or-practice ECOA actions in court on behalf of the government, receives such pattern-or-practice referrals from other agencies with ECOA enforcement responsibilities and will continue to do so under the legislation. By subjecting the CFPB to the same referral requirement, the legislation intends to avoid creating fragmentation in this enforcement system under the ECOA where none currently exists.

Title XIV creates a strong, new set of underwriting requirements for residential mortgage loans. An important part of this new regime is the creation of a safe harbor for certain loans made according to the standards set out in the bill, and which will be detailed further in forthcoming regulations. Loans that meet this standard, called "qualified mortgages," will have the benefit of a presumption that they are affordable to the borrowers.

Section 1411 explains the basis on which the regulator must establish the standards lenders will use to determine the ability of borrowers to repay their mortgages. Section 1412 provides that lenders that make loans according to these standards would enjoy the rebuttable presumption of the safe harbor for qualified mortgages established by this section. These standards include the need to document a borrower's income, among others. However, certain refinance loans, such as VA-guaranteed mortgages refinanced under the VA Interest Rate Reduction Loan Program or the FHA streamlined refinance program, which are rate-term refinance loans and are not cash-out refinances, may be made without fully reunderwriting the borrower, subject to certain protections laid out in the legislation, while still remaining qualified mortgages.

It is the conferees' intent that the Federal Reserve Board and the CFPB use their rulemaking authority under the enumerated consumer statutes and this legislation to extend this same benefit for conventional streamlined refinance programs where the party making the new loan already owns the credit risk. This will enable current homeowners to take advantage of current low interest rates to refinance their mortgages.

There are a number of provisions in title XIV for which there is not a specified effective date other than what is provided in section 1400(c). It is the intention of the conferees that provisions in title XIV that do not require regulations become effective no later than 18 months after the designated transfer date for the CFPB, as required by section 1400(c). However, the conferees encourage the Federal Reserve Board and the CFPB to act as expeditiously as possible to promulgate regulations so that the provisions of title XIV are put into effect sooner.

I would like to clarify that the conferees consider any program or initiative that was announced before June 25 to have been initiated for the purposes of section 1302 of the conference report. I also want to make clear that the conferees do not intend for section 1302 to prevent the Treasury Department from adjusting available resources that remain after the adoption of the conference report among such existing programs, based on effectiveness.

Mr. President, I also wish to explain some of the securities-related changes that emerged from the conference committee in the conference report.

The report amends section 408 to eliminate the blanket exemption for private equity funds and replace it with an exemption for private fund advisers with less than $150 million under management. The amendment also requires the SEC in its rulemaking to impose registration and examination procedures for such funds that reflect the level of systemic risk posed by midsized private funds.

Section 913 has been amended to combine the principle of conducting a study on the standard of care to investors in the Senate bill with a grant of additional authority to the SEC to act, such as is contained in the House-passed bill. The section requires the SEC to conduct a study prior to taking action or conducting rulemaking in this area. The study will include a review of the effectiveness of existing legal or regulatory standards of care and whether there are regulatory gaps, shortcomings or overlaps in legal or regulatory standards. Even if there is an overlap or a gap, the Commission should not act unless eliminating the overlap or filling a gap would improve investor protection and is in the public interest. The study would require a review of the effectiveness, frequency, and duration of the regulatory examinations of brokers, dealers, and investment advisers. In this review, the paramount issue is effectiveness. If regulatory examinations are frequent or lengthy but fail to identify significant misconduct—for example, examinations of Bernard L. Madoff Investment Securities, LLC—they waste resources and create an illusion of effective regulatory oversight that misleads the public. The SEC, in studying potential impacts that would result from changes to the regulation or standard of care, should seek to preserve consumer access to products and services, including access for persons in rural locations. In assessing the potential costs and benefits, the SEC should take into account the net costs or the difference between additional costs and additional benefits. For example, it should consider not only higher transaction or advisory charges or fees but also the return on investment if an investor receives better recommendations that result in higher profits through paying higher fees. After reporting to Congress, the SEC is required to consider the findings, conclusions, and recommendations of its study.

New section 914 requires the SEC to study the need for enhanced examination and enforcement "resources." The study of resources should not be limited to financial resources but should consider human resources also. Human resources involves whether there is a need for enhanced expertise, competence, and motivation to conduct examinations that satisfactorily identify problems or misconduct in the regulated entity. For example, if examinations fail to identify misconduct due to insufficient staff expertise, competence, or motivation, the study should conclude that there is a need for more effective staff or better management rather than merely more financial resources devoted to hiring additional staff of the same caliber.

New section 919D creates the SEC Ombudsman under the Office of the Investor Advocate. The Ombudsman can act as a liaison between the Commission and any retail investor in resolving problems that retail investors may have with the Commission or with self-regulatory organizations and to review and make recommendations regarding policies and procedures to encourage persons to present questions to the Investor Advocate regarding compliance with the securities laws. This list of duties in subsection (8)(B) is not intended to be an exhaustive list. For example, if the Investor Advocate assigns the Ombudsman duties to act as a liaison with persons who have problems in dealing with the Commission resulting from the regulatory activities of the Commission, this would not be prohibited by this legislation.

Title IX, subtitle B creates many new powers for the SEC. The SEC is expected to use these powers responsibly to better protect investors.

Section 922 has been amended to eliminate the right of a whistleblower to appeal the amount of an award. While the whistleblower cannot appeal the SEC's monetary award determination, this provision is intended to limit the SEC's administrative burden and not to encourage making small awards. The Congress intends that the SEC make awards that are sufficiently robust to motivate potential whistleblowers to share their information and to overcome the fear of risk of the loss of their positions. Unless the whistleblowers come forward, the Federal Government will not know about the frauds and misconduct.

In section 939B, the Report eliminated an exception so that credit rating agencies will be subject to regulation FD. Under this change, issuers would be required to disclose financial information to the public when they give it to rating agencies.

In section 939F, the report requires the SEC to study the credit rating process for structured finance products and the conflicts of interest associated with the issuer-pay and the subscriber-pay models; the feasibility of establishing a system in which a public or private utility or a self-regulatory organization assigns nationally recognized statistical rating organizations to determine the credit ratings of structured finance products. The report directs the SEC to implement the system for assigning credit ratings that was in the base text unless it determines that an alternative system would better serve the public interest and the protection of investors.

The report limits the exemption from risk retention requirements for qualified residential mortgages, by specifying that the definition of "qualified residential mortgage" may be no broader than the definition of "qualified mortgage" contained in section 1412 of the report, which amends section 129C of the Truth in Lending Act. The report contains the following technical errors: the reference to "section 129C(c)(2)" in subsection (e)(4)(C) of the new section 15G of the Securities and Exchange Act, created by section 941 of the report should read "section 129C(b)(2)." In addition, the references to "subsection" in paragraphs (e)(4)(A) and (e)(5) of the newly created section 15G should read "section." We intend to correct these in future legislation.

The report amended the say on pay provision in section 951 by adding a shareholder vote on how frequently the compare should give shareholders a "say on pay" vote. The shareholders will vote to have it every 1, 2, or 3 years, and the issuer must allow them to have this choice at least every 6 years. Also in section 951, the report required issuers to give shareholders an advisory vote on any agreements, or golden parachutes, that they make with their executive officers regarding compensation the executives would receive upon completion of an acquisition, merger, or sale of the company.

The report required Federal financial regulators to jointly write rules requiring financial institutions such as banks, investment advisers, and broker-dealers to disclose the structures of their incentive-based compensation arrangements, to determine whether such structures provide excessive compensation or could lead to material losses at the financial institution and prohibiting types of incentive-based payment arrangements that encourage inappropriate risks.

In section 952, the report exempted controlled companies, limited partnerships, and certain other entities from requirements for an independent compensation committee.

Section 962 provides for triennial reports on personnel management. One item to be studied involves Commission actions regarding employees who have failed to perform their duties, an issue that members raised during the Banking Committee's hearing entitled "Oversight of the SEC's Failure to Identify the Bernard L. Madoff Ponzi Scheme and How to Improve SEC Performance," as well as circumstances under which the Commission has issued to employees a notice of termination. The GAO is directed to study how the Commission deals with employees who fail to perform their duties as well as its fairness when they issue a notice of termination. In the latter situation, they should consider specific cases and circumstances, while preserving employee privacy. The SEC is expected to cooperate in making data available to the GAO to perform its studies.

In section 967, the report directs the SEC to hire an independent consultant with expertise in organizational restructuring and the capital markets to examine the SEC's internal operations, structure, funding, relationship with self-regulatory organizations and other entities and make recommendations. During the conference, some conferees expressed concern about objectivity of a study undertaken by the SEC itself. We are confident that the SEC will allow the "independent consultant" to work without censorship or inappropriate influence and the final product will be objective and accurate.

The report also added section 968 which directs the GAO to study the "revolving door" at the SEC. The GAO will review the number of employees who leave the SEC to work for financial institutions and conflicts related to this situation.

The report removed the Senate provision on majority voting in subtitle G which required a nominee for director who does not receive the majority of shareholder votes in uncontested elections to resign unless the remaining directors unanimously voted that it was in the best interest of the company and shareholders not to accept the resignation.

The report added the authority for the SEC to exempt an issuer or class of issuers from proxy access rules written under section 971 after taking into account the burden on small issuers.

In section 975, the report added a requirement that the MSRB rules require municipal advisors to observe a fiduciary duty to the municipal entities they advise.

In section 975, the report changed the requirement that a majority of the board "are not associated with any broker, dealer, municipal securities dealer, or municipal advisor" to a requirement that the majority be "independent of any municipal securities broker, municipal securities dealer, or municipal advisor."

In section 978, the report authorized the SEC to set up a system to fund the Government Accounting Standards Board, the body which establishes standards of State and local government accounting and financial reporting.

The report added section 989F, a GAO Study of Person to Person Lending, to recommend how this activity should be regulated.

The report added section 989G to exempt issuers with less than $75 million market capitalization from section 404(b) of the Sarbanes-Oxley Act of 2002 which regulates companies' internal financial controls. This section also adds an SEC study to determine how the Commission could reduce the burden of complying with section 404(b) of the Sarbanes-Oxley Act of 2002 for companies whose market capitalization is between $75 million and $250 million for the relevant reporting period while maintaining investor protections for such companies.

Section 989I adds a follow-up GAO study on the impact of the Sarbanes-Oxley section 404(b) exemption in section 989G of this bill involving the frequency of accounting restatements, cost of capital, investor confidence in the integrity of financial statements and other matters, so we can understand its effect.

The report added section 989J, which provides that fixed-index annuities be regulated as insurance products, not as securities. This provision clarifies a disagreement on the legal status of these products.

In section 991, the report changed the method of funding for the SEC so that it remains under the congressional appropriations process while giving the SEC much more control over the amount of its funding. The report also doubled the SEC authorization between 2010 and 2015, going from $1.1 billion to $2.25 billion, which will provide tremendous increase in SEC financial resources. These resources can be used to improve technology and attract needed securities and managerial expertise. However, the inspector general of the SEC and others have reported on situations where SEC financial or human resources have not been used effectively or with appropriate prior cost-benefit analysis. While the SEC is receiving more resources, we expect that it will use resources efficiently.

Congressman Himes – Congressman Frank: The Volcker Rule

Mr. HIMES. Madam Speaker, I rise to enter into a colloquy with Chairman Frank. I want to clarify a couple of important issues under section 619 of the bill, the Volcker Rule.

The bill would prohibit firms from investing in traditional private equity funds and hedge funds. Because the bill uses the very broad Investment Company Act approach to define private equity and hedge funds, it could technically apply to lots of corporate structures, and not just the hedge funds and private equity funds.

I want to confirm that when firms own or control subsidiaries or joint ventures that are used to hold other investments, that the Volcker Rule won't deem those things to be private equity or hedge funds and disrupt the way the firms structure their normal investment holdings.

Mr. FRANK of Massachusetts. If the gentleman would yield, let me say, first, you know, there has been some mockery because this bill has a large number of pages, although our bills are smaller, especially on the page. We do that—by the way, there are also other people who complain sometimes that we've left too much discretion to the regulators. It's a complex bill dealing with a lot of subjects, and we want to make sure we get it right, and we want to make sure it's interpreted correctly.

The point the gentleman makes is absolutely correct. We do not want these overdone. We don't want there to be excessive regulation. And the distinction the gentleman draws is very much in this bill, and we are confident that the regulators will appreciate that distinction, maintain it, and we will be there to make sure that they do.

Mr. HIMES. Thank you, Mr. Chairman.

My understanding is also that, consistent with the overall intent not to subject commercial firms to financial regulation, section 604 provides that an existing savings and loan holding company with both financial and nonfinancial businesses will cease to be an S&L holding company when it establishes an intermediate holding company under section 626. That company also may have an intermediate holding company under section 167.

Am I right that the intent of this legislation is for these sections to be applied in harmony, so that an organization will have a single intermediate holding company that will be both the regulated S&L holding company and the organization and the holding company for implementing the heightened supervision of systemic financial activities under title I?

Mr. FRANK of Massachusetts. If the gentleman will yield again, yes, he is exactly right. And just to sum it up, we want regulated some activities and not regulated other activities when you have a hybrid kind of situation, and what the gentleman has described is how you accomplish that.

Congressman Waters – Congressman Frank

Mr. FRANK of Massachusetts. Mr. Speaker, to begin, I want to yield for a colloquy 3 minutes to one of the leaders in the House and certainly in our committee in forging this particular legislation and in fighting to make sure that fairness is done throughout all of our efforts, the gentlewoman from California (Ms. Waters).

Ms. WATERS. Mr. Speaker, Members, I would like to begin by thanking the chair of the Financial Services Committee, my colleague, Mr. Barney Frank, for the leadership that he has provided in bringing us to this point in doing regulatory reform. There were times I thought it would never happen, but because of his brilliance, and because of his leadership, and because of his ability to listen to all of the Members who serve not only on that committee but on the conference committee, we finds ourselves here.

But I would like at this point in time to engage my chairman to make sure that I understand one particular word that was used in this conference committee report.

So if I may make an inquiry of the gentleman from Massachusetts. I'm trying to understand the meaning of the world "initiated" in paragraph 5 of the conference report. Would "initiated" include any program or initiative that has been announced by Treasury prior to June 25, 2010? And if so, I assume that that means that programs such as the FHA refinance program, which would address the problem of negative equity and which I understand Treasury and the FHA are working on but is not yet publicly available, would be included as would the Hardest Hit Fund program, which is not fully implemented yet.

And this would not prevent, for example, within the $50 billion already allocated for HAMP, perhaps adjusting resources between already-initiated programs based on their effectiveness.

Mr. FRANK of Massachusetts. If the gentlewoman would yield.

The answer is a resounding yes. And I certainly have been following her leadership in trying to make sure that these programs do more than many of them have done.

So the answer to her question is yes. Nothing new can be started after June 25, but it does not reach back and strangle in the cradle those programs that were under way. I confirm that the conference report would not prevent adjusting resources between already initiated programs based on their effectiveness.

Ms. WATERS. Thank you. I appreciate that.

Congressman Bacchus – Frank Interchange regarding Title II (Orderly Liquidation)

Mr. BACHUS. Mr. Speaker, I yield myself 5 minutes.

Mr. Speaker, today I would like to address the good, the bad, and the ugly in this bill.

The good: There is consumer protection. There is more disclosure and transparency. There are some bipartisan provisions in this bill that add a whistleblower office to the SEC. But the bad and the ugly far outweigh those.

In total, this bill is a massive intrusion of Federal Government into the lives of every American. It is the financial services equivalent of ObamaCare, the government takeover of our health care system.

If finally enacted, it will move us further toward a managed economy, with the Federal Government's making decisions that have been and should stay in the hands of individuals and private businesses.

For instance, it will make the compensation of every employee of a financial firm subject to rules set by a government overseer. Can you imagine anything as basic as what an employer pays an employee controlled by a Federal bureaucrat in Washington? It will even apply to clerical employees. Government regulators will be empowered to seize and break up even healthy firms they decide are systemic risks and to even appoint new management to run these private companies.

As I said on the floor earlier today, this bill will institutionalize AIG-type bailouts of creditors and counterparties, and it will saddle taxpayers with the losses resulting from out-of-control risk-taking by Wall Street institutions—gamblers. My colleagues on the other side of the aisle will tell you this bill does not include a bailout fund. They are wrong.

As I explained earlier, here it is, laid out. You can lend money to a failing company. Now, how do you get money back from a failing company?

You can purchase their assets. You can guarantee their obligations. You can sell or transfer their assets. It is there.

What does this cost?

As I explained earlier, the FDIC can borrow up to 90 percent of a firm's assets. That's $2 trillion in the case of Bank of America alone. They could borrow $2.1 trillion in that case alone. That is a bailout fund, period.

Not only will it make bailouts permanent, but it will empower government employees to go around settled bankruptcy law in so-called "resolutions," done behind closed doors, with unequal treatment of creditors at the whim of politically influenced government officials. This has already happened. A financial firm's ability to survive a crisis like the one we went through 2 years ago will depend, as it did then, on whether its CEO can get the President of the New

York Fed on the phone on a Saturday night, as one firm did. Friendships and being well-connected should not determine the success or failure of private enterprises.

Finally, it imposes an $11 billion tax disguised as an FDIC assessment. To fund this new government spending, they tax Main Street banks and financial institutions. They raise their FDIC premiums even though those premiums would go to bail out Wall Street firms and not to save depositors, as the system was designed to do.

Mr. Speaker, if you voted against this bill on the floor, if you voted against it in committee, you need to vote against it again, because it is even worse than when it came out of the House.

We have seen the anger and frustration generated by the injustice of too-big-to-fail bailouts. We have seen the folly of implied guarantees as with Fannie and Freddie. We have seen, time after time, the failure of government-run schemes to create jobs and to grow the real economy. Nevertheless, here the majority party is again, doing the same thing over and over, blindly hoping that, suddenly, this time, they will get a different result. Well, you're right. The American people are demanding a different result, and in a series of recent elections, they have told incumbents to go home and to spend their own money, not theirs—not the taxpayers'.

In conclusion, if you choose to bail out the creditors and counterparties of the big Wall Street firms or to loan them money when they get in trouble, don't expect the voters to bail you out come November.

I reserve the balance of my time.

Mr. FRANK of Massachusetts. Mr. Speaker, I yield myself such time as I may consume to correct a very incomplete picture that was just given.

The gentleman keeps quoting that one section. I'm astonished—astonished—that he quotes it so blatantly out of context. Yes, there are powers that are given. Clearly, in the bill, it is only once the entity has been put into receivership on its way to liquidation.

The gentleman from Alabama has several times today talked about the powers as if they were just randomly given. I will be distributing the entirety of this, and it is the most distorted picture of a bill I have seen. The title, by the way, is headed: Orderly Liquidation of Current Financial Companies. The purpose of this title is to provide the necessary authority to liquidate failing financial companies. Again, I am astonished that he would not give the Members the full picture that comes as part of a subtitle that reads: Funding for Orderly Liquidation.

Mr. BACHUS. Will the gentleman yield?

Mr. FRANK of Massachusetts. Yes.

Mr. BACHUS. When I say they shouldn't bail out the creditors and counterparties, I don't care whether they are in receivership or not. They should not bail them out, period.

Mr. FRANK of Massachusetts. Reclaiming my time, Mr. Speaker, please, let's get this started on the right point. Instruct the gentleman as to the rules. I thought he was going to ask me about what I said.

He has consistently read a part of this section, leaving out the part that would help Members understand it. He didn't say what he just said. He said he read these as if they were there in general. The powers he talked about come in the subsets of the section: Funding for Orderly Liquidation.

Those powers are just upon the appointment of a receiver. So this is not to keep an institution going. This is not AIG. Yes, he can be critical about the Bush administration on its own, without Congress, with regard to AIG. We repeal in this bill the power under which they acted and with the Federal Reserve's concurrence. By the way, it also says in here that those powers are subject to section 206.

Again, I don't know why the gentleman—I guess I do know why they would want to read this, but let me read it because it corrects entirely the wholly inaccurate picture he gave people. The actions that he read can be taken if the corporation determines mandatory terms and conditions for all orderly liquidation actions.

AIG was kept alive. This cannot be kept alive. This happens only as the death of the institution comes. He may think the Bush administration picked its friends. I think he is being unfair to Mr. Bernanke. I think he is being unfair to Mr. Paulson and Mr. Geithner. Anyway, here are the rules they would have to follow:

First, they would have to determine that such action is necessary for purposes of the financial stability and not for the purpose of preserving the covered company.

Two, they would have to ensure that the shareholders do not receive payment until the claims are paid.

They would have to ensure that unsecured creditors bear losses in accordance with the priority of claims in section 210. That is the FDIC.

They would have to ensure that the management is removed, and they would have to ensure that the members of the board of directors are removed.

So it is quite the opposite of what the gentleman talked about. It says that, if an institution has gotten so indebted that it should not be able to pay its debts, we would step in, and we would put it out of business. It is totally different from what happened with AIG. It does then say, yes, in some circumstances, there may be an ability to do these things but only after the institution has been liquidated.

The gentleman never mentioned that. The gentleman talks about it and talks about it, and he never mentions that this is only as the institution is being put out of business. It is also very clear elsewhere in here that any funds expended will come from the financial institutions, not from the taxpayers.

Now, we had a good piece of legislation that we had adopted in conference in order to try to do that here. Unfortunately, to get the Republican votes necessary in the Senate for an otherwise very good bill, we had to back that down, but it didn't change in here.

So, yes, there are provisions that the gentleman read, but unlike the way he presented them, they don't stand by themselves. They come only after it has been determined by the administration in power that the financial stability of the company requires, first, that the company be liquidated and, second, that some attention be given to its debts, but it will be funding out of the other financial institutions, not from the taxpayers.

I reserve the balance of my time.

Mr. BACHUS. At this time, I yield 3 minutes to the gentleman from Texas (Mr. Smith), the ranking member of the Judiciary.

Congressman Peterson – Title VII (Derivatives)

Mr. PETERSON. I thank the gentleman for yielding.

Mr. Speaker, I rise today in support of the conference report on H.R. 4173, The Wall Street Reform and Consumer Protection Act.

I want to start by thanking Chairman Frank, who has demonstrated his great policymaking skills and leadership on this important issue.

The staffs of both the House Agriculture Committee and the Financial Services Committee have worked closely on this legislation for the past year, and it is thanks to our efforts that we have a conference committee report for us today.

One of the bill's key components is title VII, which brings greater transparency and accountability to derivative markets. When the House considered financial reform in December, derivatives were one area in which we had strong bipartisan support. The House produced a very good product. The Senate's efforts on derivatives went in a very different direction. As with any legislation with such stark differences, compromises had to be made.

This comprehensive legislation represents a middle ground between the House and Senate products. While no one got everything they wanted in this bill, I think we got a bill that will help prevent another crisis in the financial markets like the one we experienced in 2008.

The House Agriculture Committee started looking at some of the issues addressed in this legislation even before evidence of the financial crisis started to appear. I am pleased that the conference report contains many of the provisions the House Ag Committee endorsed over the course of passing three bills on this topic. Let me briefly talk about some of those provisions.

Our in-depth review of derivative markets began when we experienced significant price volatility in energy futures markets due to excessive speculation—first with natural gas and then with crude oil. We all remember when we had $147 oil. The Ag Committee examined the influx of new traders in these markets, including hedge funds and index funds, and we looked at the relationship between what was occurring on regulated markets and the even larger unregulated over-the-counter market. This conference report includes the tools we authorized and the direction to the CFTC to mitigate outrageous price spikes we saw 2 years ago.

The House Agriculture Committee also spent a great deal of time considering the role of derivatives in the collapse of the financial markets and debating different approaches to regulating these financial tools.

In the end, it was the Agriculture Committee, on a bipartisan basis, that embraced mandatory clearing well before the idea became popular. Clearing is not only a means to bring greater transparency to the derivative markets, but it also should reduce the risk that was prevalent throughout the over-the-counter market. The conference report closely follows the House approach to mandatory clearing.

In crafting the House bill and the conference report, we focused on creating a regulatory approach that permits the so-called end users to continue using derivatives to hedge risks associated with their underlying businesses, whether it is energy exploration, manufacturing, or commercial activities. End users did not cause the financial crisis of 2008. They were actually the victims of it.

Now, that has been of some concern and, frankly, a misinterpretation of the conference report's language regarding capital and margin requirements by some who want to portray these requirements as applying to end users of derivatives. This is patently false.

The section in question governs the regulation of major swap participants and swap dealers, and its provisions apply only to major swap participants and swap dealers. Nowhere in this section do we give regulators any authority to impose capital and margin requirements on end users. What is going on here is that the Wall Street firms want to get out of the margin requirements, and they are playing on the fears of the end users in order to obtain exemptions for themselves.

One of the sources of financial instability in 2008 was that derivative traders like AIG did not have the resources to back up their transactions. If we don't require these major swap participants and swap dealers to put more backing behind their swap deals, we will only perpetuate this instability. That is not good for these markets, and it is certainly not good for end users.

I am confident that after passing this conference report we can go home to our constituents and say that we have cracked down on Wall Street and the too-big-to-fail firms that caused the financial crisis.

With that, I urge my colleagues to support the passage of this conference report.

I reserve the balance of my time.

Mr. PETERSON. Mr. Speaker, I yield such time as he may consume to the gentleman from Pennsylvania (Mr. Holden).

Mr. HOLDEN. I thank the chairman for yielding.

I rise today in support of H.R. 4173.

I serve as chairman of the House Agriculture Subcommittee on Conservation, Credit, Energy, and Research. As such, we have jurisdiction over the institutions of the Farm Credit System that serve agriculture as well as rural communities across the country.

Over 20 years ago, the Agriculture Committee put in place a revised legislative and regulatory regime for the Farm Credit System that has successfully stood the test of time in ensuring that these institutions operate safe and sound.

Farm Credit System institutions are regulated and examined by a fully empowered independent regulatory agency, the Farm Credit Administration, which has the authority to shut down and liquidate a system institution that is not financially viable. In addition, the Farm Credit System is the only GSE that has a self-funded insurance program in place that was established to not only protect investors in farm credit debt securities against loss of their principal and interest, but also to protect taxpayers.

These are just a few of the reasons why the Agriculture Committee insisted that the institutions of the Farm Credit System not be subject to a number of the provisions of this legislation. They were not the cause of the problem, did not utilize TARP funds, and did not engage in abusive subprime lending. We have believed that this legislation should not do anything to disrupt this record of success.

Mr. Speaker, I now would like to enter into a colloquy with the chairman of the Agriculture Committee.

Mr. Chairman, the conference report includes compromise language that requires the Commodity Futures Trading Commission to consider exempting small banks, Farm Credit System institutions and credit unions from provisions requiring that all swaps be cleared. We understand that community banks, Farm Credit institutions and credit unions did not cause the financial crisis that precipitated this legislation. While the legislation places a special emphasis on institutions with less than $10 billion in assets, my reading of the language is that they should not in any way be viewed by the Commodity Futures Trading Commission as a limit on the size of the institution that should be considered for an exemption.

Mr. Chairman, would you concur with this assessment?

Mr. PETERSON. Yes, I fully agree. The language says that institutions to be considered for the exemption shall include those with $10 billion or less in assets. It is not a firm standard. Some firms with larger assets could qualify, while some with smaller assets may not. The regulators will have maximum flexibility when looking at the risk portfolio of these institutions for consideration of an exemption.

Mr. HOLDEN. I thank the chairman.

Congressman Peterson – Boswell Exchange regarding Swap Definition

Mr. PETERSON. Mr. Speaker, I yield such time as he may consume to the gentleman from Iowa (Mr. Boswell).

Mr. BOSWELL. Mr. Speaker, I would like to engage the chairman in a colloquy.

I would like to briefly clarify an important point with the chairman regarding the intention of one of the exclusions from the definition of "swap." The exclusion from the definition of swap for "any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled," is intended to be consistent with the forward contract exclusion that is currently in the Commodity Exchange Act and CFTC's established policy on this subject. Physical commodity transactions should not be regulated as swaps as that term is defined in this legislation. This is true even if commercial parties agree to "book-out" their delivery obligations under a forward contract.

For those who may not be familiar with terminology used in the trade, a book-out is a second agreement between two commercial parties to a forward contract who find themselves in a delivery chain or circle at the same delivery point. They can agree to settle their delivery obligations by exchanging a net payment if there has been some change arising since the initial forward contract was entered into. Simply put, book-outs reduce transaction costs, and that saves consumers money.

Can the chairman clarify this for me?

I yield to the chairman.

Mr. PETERSON. The gentleman is correct. My interpretation of the exclusionary provision from the definition of swap that he mentioned is that the exclusion would apply to transactions in which the parties' delivery obligations are booked-out, as the gentleman described. The fact that the parties may subsequently agree to settle their obligations with a payment based on a price difference through a book-out does not turn a forward contract into a swap.

Excluding physical forward contracts, including book-outs, is consistent with the CFTC's longstanding view that physical forward contracts in which the parties later agree to book-out their delivery obligations for commercial convenience are excluded from its jurisdiction. Nothing in this legislation changes that result with respect to commercial forward contracts.

Mr. BOSWELL. I thank the chairman for the clarification.

Mr. PETERSON. I thank the gentleman.

I encourage people to support the conference report.

I have no further requests for time, and I yield back the balance of my time.

Congressman Kanjorski – General Colloquy.

KANJORSKI asked and was given permission to revise and extend his remarks.)

Mr. KANJORSKI. Mr. Speaker, I rise in support of the conference agreement.

Mr. Speaker, this is not a perfect bill, but this is a darn good bill. I know we are going to hear objections on both sides of the aisle, but if you have a chance to look at it, and it is a lengthy bill, the 2,600 pages that are presented to both the House today and within a week or so to the Senate constitutes the first revolutionary change of securities laws in the United States since the Great Depression. At that time we had a tremendous collapse, and our forefathers and predecessors rose to the occasion by establishing a regulatory platform within the United States that made us the envy of the world.

We had in 2008 a collapse and a failure of that system. It primarily grew out of the failure of the regulatory system to use all the powers it had and to keep track with our highly speculative and greedful nature at the time to allow us to go into the tremendous credit crisis that we faced in 2008.

To now make an argument that we need do nothing and we will recover and we will prosper is pure ludicrousness. The fact of the matter is there are holes, there are loopholes, there are failures within our system. We have to cleanse that system and fix that system, and that is exactly what this bill does.

I am pleased to say that I had a part in doing that. I helped prepare one amendment, the too-big-to-fail amendment. What we can say to our successors and to our constituents is that never again in the future will there be an unlimited power for financial institutions to grow either in size, interconnectedness or other negative factors that they can remain and put in jeopardy systemically the economy of the United States and the world.

We have the authority vested in our regulators to see that that doesn't happen. If our regulators are able and will use those powers, never again will we face the too-big-to-fail concept of having to bail out some of the largest institutions in the world.

Secondly, a large part of this was devoted to investor protection. I can't go through all the elements, but for the first time in history we're going to allow the regulators to study and come up with rules and regulations that allow a fiduciary relationship between broker-dealers, investment advisers, and their clients—their customers. Most people in this country think that already exists. It doesn't. After this bill and the use of those new regulations, it will. You can then trust that the advice being given by the broker-dealer or the investment counselor is in your best interest as a customer and not in theirs.

We also call for the largest comprehensive study of the Securities and Exchange Commission in the history of the commission. It will put into place the tools necessary to revise the entire SEC in the future. It also will be the predicate for that type of a comprehensive study to be used in other agencies and commissions of government to allow us the long road of reform in the American government. These things are in the bill. Beside that, we have the capacity to require that no one in the future need worry about the responsibility of the companies they're dealing with as to whether or not they will have counterparties, whether they are relying on representations that are true or false, because we're going to have transparency within the system.

In the other areas dealing with derivatives, we're going to have exchanges. We're going to have disclosure. Never has that happened in the history of the United States. Over the years, the last two decades, we have made attempts and have always failed. This time we have succeeded.

Mr. Speaker, without reservation, I recommend to my colleagues a vote of "yes" on this bill.

INTRODUCTION

Mr. Speaker, after nearly two years of study, discussion, hearings, and intense legislative negotiations, we have produced a final bill that will considerably strengthen our financial services infrastructure, a system that not only underpins the American economy but one that also serves as a cornerstone of our global markets. This bill also represents the most significant overhaul of our Nation's financial services regulatory framework since the reforms put in place during the Great Depression.

This landmark agreement touches upon nearly every corner of our financial markets. Among other things, this bill ends the era in which financial institutions can become too big to fail in several ways, including my provision to allow regulators to preemptively break up healthy financial firms that pose a grave threat to the U.S. economy. Additionally, the bill regulates financial derivatives for the first time, establishes procedures for shutting down failing financial companies in an orderly manner, forces the registration of hedge fund advisers, and holds credit rating agencies accountable through greater liability. This bill also greatly expands investor protections by setting up a fiduciary standard for broker-dealers offering personalized investment advice, allowing shareholders to nominate candidates for corporate boards, and creating a bounty program to reward whistleblowers whose tips lead to successful enforcement actions.

Moreover, this legislation enhances the powers and resources of the U.S. Securities and Exchange Commission, SEC. The pending conference agreement also forces a comprehensive study of the way that the SEC operates which will lead to much needed management reforms. Furthermore, the conference agreement creates for the first time a Federal office to monitor insurance matters. Finally, this bill will comprehensively modify mortgage lending practices—including escrow procedures, mortgage servicing, and appraisal activities.

In short, the conference report on H.R. 4173 is a very good package that will restructure the foundations of the U.S. financial system. It will enhance regulation over more products and actors, create additional investor protections and consumer safeguards, and promote greater accountability for those who work in our capital markets. For these reasons, I urge my colleagues to vote in favor of this momentous agreement.

ENDING TOO BIG TO FAIL

Historians will likely long argue about the causes of the 2008 credit crunch, but one cannot deny that one huge contributing factor was the failure of government regulators to rein in dangerous financial institutions. Giant films like American International Group, AIG, as well as many smaller firms, engaged in recklessly risky behavior that rewarded them with huge profits during the build-up of the housing bubble, but then nearly wiped them out as the bubble burst. Actually, AIG and other firms would have collapsed and our economy would have been sent back to the Dark Ages, except for the request of the Bush Administration to establish the $700 billion Troubled Asset Relief Program to prop up our country's teetering financial system.

Those terrifying months in late 2008 convinced me that the Federal government needed to play a far more vigorous role in policing the activities of the major financial players in our economy. During the last two years, my top priority has therefore been to avoid having any future Congress face the same dilemma that we faced in 2008: "bail out" Wall Street to save Main Street or risk the collapse of the entire American economy. I decided that the most important element of any reform of the financial system needed to ensure that no financial firm could be allowed to become so big, interconnected, or risky that its failure would endanger the whole economy.

In this regard, I am pleased that this legislation helps bring an end to the era of too-big-to-fail financial institutions in at least three significant ways. First, it achieves this end by establishing new regulatory authorities to dissolve and liquidate failing financial institutions in an orderly manner that protects our overall economy. The Obama Administration proposed these much needed reforms as an initial step for ending the problem of too big to fail.

Second, the conference agreement incorporates my amendment vesting regulators with the power to limit the activities of and even disband seemingly healthy financial services firms. Specifically, the Kanjorski amendment permits regulators to preemptively break up and take other actions against financial institutions whose size, scope, nature, scale, concentration, interconnectedness, or mix of activities pose a grave threat to the financial stability or economy of the United States.

Third, the final agreement contains a fairly strong Volcker rule that will limit the activities of financial institutions going forward and prevent them from becoming too big to fail. Inspired by the legendary former Federal Reserve Chairman, Paul Volcker, this rule will bar proprietary trading by banks, significantly curtail bank investments in private equity funds and hedge funds, and cap the liabilities of big banks. As a result, the Volcker rule will prohibit banks from engaging in highly speculative activities that in good times produce enormous profits but in bad times can lead to collapse.

Together, these three reforms will better protect our financial system and mitigate the problem of too big to fail. The Kanjorski amendment and the Volcker rule will also substantially resurrect the barrier between commercial and investment banking that resulted in a stable financial system for more than 70 years after the Great Depression.

As the Wall Street Journal on Saturday reported, ". . . the bill gives regulators power to constrain the activities of big banks, including forcing them to divest certain operations and to hold more money to protect against losses. If those buffers don't work, the government would have the power to seize and liquidate a failing financial company that poses a threat to the broader economy." I wholeheartedly agree with this independent assessment.

In sum, the conference agreement on H.R. 4173 represents an historic achievement. By addressing the problem of too big to fail, this legislation will lead to a new era of American prosperity and financial stability for decades to come. For this reason alone, this bill deserves to become law.

INVESTOR PROTECTION AND SECURITIES REFORMS

As the House developed this legislation, I played a key role in drafting the title concerning investor protection and securities reform. The Administration's proposal and the Senate's bill contained some important improvements, but the initial House plan had many, many more. I am pleased that the final package more closely resembles the initial House legislation rather than the original Administration and Senate plans.

Among its chief reforms in the area of investor protection, the conference agreement provides that the SEC, after it conducts a study, may issue new rules establishing that every financial intermediary who provides personalized investment advice to retail customers will have a fiduciary duty to the investor. A traditional fiduciary duty includes an affirmative duty of care, loyalty and honesty; an affirmative duty to act in good faith; and a duty to act in the best interests of the client. Through this harmonized standard of care, both broker-dealers and investment advisers will place customers' interests first.

Regulators, practitioners, and investor advocates have become increasingly concerned that investors are confused by the legal distinction between broker-dealers and investment advisers. The two professions currently owe investors different standards of care, even though their services and marketing have become increasingly indistinguishable to retail investors. The issuance of new rules will fix this long-standing problem.

Additionally, the legislation adopts recommendations made by SEC Chairman Mary Schapiro, SEC Inspector General David Kotz, and Harry Markopolos, the whistleblower who sought for many years to get regulators to shut down the $65 billion Ponzi scheme perpetrated by Bernard Madoff. Specifically, the conference agreement provides the SEC with the authority to establish an Investor Protection Fund to pay whistleblowers whose tips lead to successful enforcement actions. The SEC currently has such authority to compensate sources in insider trading cases, and the whistleblower provision in this bill would extend the SEC's power to compensate other tipsters who bring substantial evidence of other securities law violations.

The conference agreement also responds to other problems laid bare by the Madoff fraud. These changes include increasing the line of credit at the U.S. Treasury from $1 billion to $2.5 billion to support the work of the Securities Investor Protection Corporation, SIPC, and raising SIPC's maximum cash advance amount to $250,000 in order to bring the program in line with the protection provided by the Federal Deposit Insurance Corporation.

This bill additionally increases the minimum assessments paid by SIPC members from $150 per year, regardless of the size of the SIPC member, to 2 basis points of a SIPC member's gross revenues. This fix will help to ensure that SIPC has the reserves it needs in the future to meet its obligations. Finally, in response to the Madoff fraud, the final product includes my legislation to allow the Public Company Accounting Oversight Board to examine the auditors of broker-dealers.

For too long, securities industry practices have deprived investors of a choice when seeking dispute settlement, too. In particular, pre-dispute mandatory arbitration clauses inserted into contracts have limited the ability of defrauded investors to seek redress. Brokerage firms contend that arbitration is fair and efficient as a dispute resolution mechanism. Critics of mandatory arbitration clauses, however, maintain that the brokerage firms hold powerful advantages over investors and hide mandatory arbitration clauses in dense contract language.

If arbitration truly offers investors the opportunity to efficiently and fairly settle disputes, then investors will choose that option. But investors should also have the choice to pursue remedies in court, should they view that option as superior to arbitration. For these reasons, the final package provides the SEC with the authority to limit, prohibit or place conditions on mandatory arbitration clauses in securities contracts.

Another significant investor protection provided in this conference agreement concerns proxy access. In particular, H.R. 4173 clarifies the ability of the SEC to issue rules regarding the nomination by shareholders of individuals to serve on the boards of public companies. These provisions regarding proxy access will enhance democratic participation in corporate governance and give investors a greater voice in the companies that they own.

A myriad of problems presently confronts the SEC, perhaps none more urgent than the need for adequate resources. Chairman Schapiro and others have repeatedly stressed the need to increase the funding to ensure that the agency has the ability to keep pace with technological advances in the securities markets, hire staff with industry expertise, and fulfill one of its core missions: the protection of investors. In response, this agreement slightly increases the independence of the SEC in the appropriations process, doubles the authorized SEC budgets over 5 years, and creates a new reserve fund to support technology improvements and address emergency situations, like the flash crash that occurred in May 2010.

Moreover, H.R. 4173 modifies the SEC's structure by creating a number of new units and positions, like an Office of the Investor Advocate, an office to administer the new whistleblower bounty program, and an Office of Credit Ratings. However, the SEC's systemic failures to effectively police the markets in recent years required Congress to do even more to shake up the agency's daily operations. As such, the legislation includes my provision mandating an expeditious, independent, comprehensive study of the securities regulatory regime by a high caliber body with expertise in organizational restructuring to identify deficiencies and reforms, and ensure that the SEC and other regulatory entities put in place further improvements designed to provide superior investor protection. My hope is that this study will ultimately become the model for reforming other agencies. The final bill also includes my deadlines generally forcing the SEC to complete enforcement, compliance examinations, and inspections within 180 days, with some limited exemptions for complex cases.

The conference agreement on H.R. 4173 additionally modifies, enhances and streamlines the powers and authorities of the SEC to hold securities fraudsters accountable and better protect investors. For example, the SEC will have the authority to impose collateral bars on individuals in order to prevent wrongdoers in one sector of the securities industry from entering another sector. The SEC will also gain the ability to make nationwide service of process available in civil actions filed in Federal courts, consistent with its powers in administrative proceedings.

The bill further facilitates the ability of the SEC to bring actions against those individuals who aid and abet securities fraud. The Securities Exchange Act of 1934 and the Investment Advisers Act of 1940 presently permit the SEC to bring actions for aiding and abetting violations of those statutes in civil enforcement cases, and this bill provides the SEC with the power to bring similar actions for aiding and abetting violations of the Securities Act of 1933 and the Investment Company Act of 1940. In addition, the bill not only clarifies that the knowledge requirement to bring a civil aiding and abetting claim can be satisfied by recklessness, but it also makes clear that the Investment Advisers Act of 1940 expressly permits the imposition of penalties on those individuals who aid and abet securities fraud.

One final investor protection reform that I drafted and want to highlight concerns the new authority of the SEC and the Justice Department to bring civil or criminal law enforcement proceedings involving transnational securities frauds. These are securities frauds in which not all of the fraudulent conduct occurs within the United States or not all of the wrongdoers are located domestically. The bill creates a single national standard for protecting investors affected by transnational frauds by codifying the authority to bring proceedings under both the conduct and the effects tests developed by the courts regardless of the jurisdiction of the proceedings.

In the case of *Morrison v. National Australia Bank*, the Supreme Court last week held that section 10(b) of the Exchange Act applies only to transactions in securities listed on United States exchanges and transactions in other securities that occur in the United States. In this case, the Court also said that it was applying a presumption against extraterritoriality. This bill's provisions concerning extraterritoriality, however, are intended to rebut that presumption by clearly indicating that Congress intends extraterritorial application in cases brought by the SEC or the Justice Department.

Thus, the purpose of the language of section 929P(b) of the bill is to make clear that in actions and proceedings brought by the SEC or the Justice Department, the specified provisions of the Securities Act, the Exchange Act and the Investment Advisers Act may have extraterritorial application, and that extraterritorial application is appropriate, irrespective of whether the securities are traded on a domestic exchange or the transactions occur in the United States, when the conduct within the United States is significant or when conduct outside the United States has a foreseeable substantial effect within the United States.

OTHER REASONS TO SUPPORT THE CONFERENCE REPORT

The bill that we are considering today contains a number of other worthwhile elements that should become law, and I want to highlight several issues on which I personally worked or in which I have a deep, long-standing interest.

First, the bill creates a Federal Insurance Office within the Treasury Department. A key component of our financial services industry, insurance is too often misunderstood or left behind in decisions made by the Federal government. As a result, I have long worked on the creation of this new office that will effectively monitor this industry sector for potential risks going forward. As a result of this new office, the United States will for the first time speak with a uniform voice on insurance matters on the international stage and have the authority to stand behind its words. I am therefore pleased that the Federal Insurance Office is finally becoming law.

Second, I have worked diligently on the title concerning the registration of hedge fund managers and private equity fund advisers. To promote market integrity, we need those individuals who handle large sums of money and assets to register with the SEC and provide information about their trades and portfolios. While I remain concerned about the registration exemptions put in place by others during the legislative process, I believe that these reforms are necessary to improve the quality of regulation and protect against systemic risk.

While hedge funds may not have directly caused this latest financial crisis, we do know that these investment vehicles have previously contributed to significant market instability, as was the case in the collapse of Long-Term Capital Management in 1998. Thus, this reform is an important step in understanding and controlling systemic risk.

Third, this legislation greatly increases the accountability of credit rating agencies. The overly optimistic assessments by Moody's, Fitch, and Standard and Poor's about the quality of structured financial products constructed out of garbage aided and abetted the financial crisis. By imposing structural, regulatory, and liability reforms on rating agencies, this agreement will change the way nationally recognized statistical rating organizations behave and ensure that they effectively perform their functions as market gatekeepers going forward.

Fourth, I am very pleased that this agreement will modify escrowing procedures, mortgage servicing, and appraisal activities. I began working 9 years ago on these issues after identifying predatory practices, faulty appraisals, and other problems in the Poconos housing markets. These reforms are long overdue.

Among other things, these new mortgage lending standards will include a requirement that all borrowers with higher-cost mortgages have an escrow account established in order to pay for property taxes and homeowners' insurance. Studies have shown that at the height of the crisis, borrowers with higher-cost mortgages were substantially less likely than borrowers with good credit records to have an escrow account. Borrowers with less than perfect credit records, however, need more help in budgeting for these sizable expenses. This bill fixes this problem.

Title XIV of the bill also has reforms with respect to force-placed insurance. Predatory lenders often impose costly force-placed insurance, even though the homeowner may already have a hazard insurance policy. This legislation will clarify the procedures for when a servicer can force place insurance. The bill's *bona fide* and reasonable cost requirements will also ensure that mortgage servicers shop around for the best rates for the force-placed insurance that they impose. Moreover, the bill's force-placed insurance reforms will ensure that consumers who are erroneously billed for such premiums will have the monies refunded within 15 business days.

Additionally, the bill's appraisal reforms will update Federal appraisal laws for the first time in a generation. We now know that inflated appraisals and appraiser coercion and collusion contributed greatly to the creation of the housing bubble. We must respond by putting in place a strong national appraisal independence standard that applies to all loans. We must also comprehensively reform the appraisal regulatory system. This bill does both things.

Fifth, I am extremely pleased that this bill provides $1 billion for a national program to offer emergency bridge loans to help unemployed workers with reasonable prospects for reemployment to keep their homes. This new national initiative is based on Pennsylvania's successful Homeowners' Emergency Mortgage Assistance Program, HEMAP. Since 1983, HEMAP has saved 43,000 homes from foreclosure by helping to cover mortgage payments until homeowners find new jobs. With unemployment rates still unacceptably too high and far too many homeowners experiencing problems in paying their mortgages through no fault of their own, the time has come to replicate HEMAP at the national level.

Finally, the lack of regulation of the over-the-counter derivatives market has been a serious concern of mine for many years. In 1994, for example, I introduced a bill to regulate derivatives and other complex financial instruments. This conference agreement finally addresses the utter lack of regulation in this enormous market by mandating the clearing of most derivative contracts on exchanges so that we have more transparency. For those derivatives that are not cleared, the bill's reporting and disclosure requirements ensure that information on the transaction is maintained.

LONG-TERM CONCERNS

A sweeping, industry-wide regulatory reform bill like this one rarely comes along. As has been the case after the enactment of other overhaul bills, we can expect problems to manifest themselves and unintended consequences to occur.

While this bill incorporates the major goals of the Volcker rule, I had hoped for an even stronger version. Unfortunately, the ban on investments in or sponsorship of hedge funds and private equity is not as robust as I would have liked. The Volcker rule could have been stronger had the conferees accepted my amendment to provide for a de minimis exemption of tangible common equity, as opposed to Tier 1 capital, and a dollar cap on the investment. This amendment would have tightened the bill and better protected our financial markets from systemic risk.

Regrettably, the legislation also permanently exempts small public companies from the Sarbanes-Oxley Act's requirement to obtain an external audit on the effectiveness of internal financial reporting controls. This exemption disregards the significant concerns of investors—those that provide capital and bear the risk of losing their retirement savings.

External audits of internal control compliance costs have dramatically decreased in recent years. The stock prices of those companies that have complied with this law have significantly outperformed the stock prices of those that have not complied. Additionally, evidence suggests that 60 percent of all financial restatements have occurred at companies that will never be required to comply with the law's external audit requirements.

Together, these facts certainly suggest that the Sarbanes-Oxley exemption provision has no place in a reform bill that is supposed to strengthen investor protections. Moreover, I am worried about the investors at the more than 5,000 public companies now exempted who may one day wake up to discover their hard earned savings pilfered by corporate accounting misdeeds as was the case in Enron, WorldCom, and Tyco.

As previously mentioned, I have additional worries about the exemptions granted to the registration of private fund advisers. There are many other types of exemptions embedded throughout this bill, including exemptions in the derivatives title and in the powers of the new Consumer Financial Protection Bureau. While I hope that regulators and the entities that they regulate will prudently apply these exemptions, I have apprehensions that in the long term the exemptions will swallow the rules. We must remain vigilant against such an outcome.

Similarly, the success of this landmark reform effort will ultimately depend on the individuals who become the regulators. The key lesson of the last decade is that financial regulators must use their powers, rather than coddle industry interests. In this regard, I hope that regulators will judiciously use the new powers that I have drafted regarding the break up of too-big-to-fail firms. If just one regulator uses these extraordinary powers just once, it will send a powerful message to industry and significantly reform how all financial services firms behave forever more.

Additionally, I continue to have apprehensions about the interchange provisions inserted into this legislation by the Senate. This issue, without question, would have benefitted from additional time and study. I am hopeful that we got the balance right and that these new limitations do not ultimately impair the performance of credit unions and community banks. If necessary, I stand ready to change the new law in this area.

There are several other lingering concerns that I have about this bill, as well. For example, it grants the Federal Reserve far more new powers than I would have liked. The bill also sets a very high bar of a two-thirds supermajority vote of the Financial Stability Oversight Council to take action under my too-big-to-fail amendment. There is some wisdom in this requirement, but if too many individuals with an anti-regulatory bias serve on the Council they will neglect to use the powers that Congress gave them in order to protect our financial system.

Finally, our work today is only a beginning, not an end. Going forward, Congress needs to attentively watch our changing financial marketplace and carefully monitor our regulators in order to protect against systemic risk, forestall potential abuses of corporate power, safeguard taxpayers, and defend the interests of consumers and investors. Moreover, the United States must continue to encourage its allies abroad to adopt strong financial services regulatory reforms so that we will have a strong, unified global financial system.

Although we may be completing our work on this bill, it is important for us to remain vigilant in each of the areas about which I have raised concerns. I, for one, plan to continue to closely monitor and carefully examine each of these matters.

CLOSING

Before closing, Mr. Speaker, I wish to congratulate the gentleman from Massachusetts, Financial Services Committee Chairman Barney Frank, for his outstanding leadership in guiding this extremely complex bill through the legislative process. This conference marks the culmination of a long, thoughtful series of hearings, markups, floor debates, and conference negotiations. Chairman Frank performed exceptionally at every stage of the process, and his name deserves to be attached to this landmark agreement. Senate Banking Committee Chairman Christopher Dodd deserves similar praise for his hard work. This is why I offered the amendment in conference to name this law the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Additionally, I want to counter the comments of those who have myopically criticized this package because it does not abolish Fannie Mae and Freddie Mac. By reforming the securitization process, risk retention requirements, and rating agency accountability, this bill lays the foundation for our upcoming work to address the future of these two institutions and, more broadly, the entire housing finance system. The reform of Fannie Mae, Freddie Mac, and the housing finance system is the next big legislative mountain that the Financial Services Committee must climb, and when the Congress returns after Independence Day, I will convene additional hearings to advance work on legislation to achieve this objective.

Mr. Speaker, while I may have some lingering doubts about this legislative package, it is overall a very good agreement. In short, the conference report represents a reasoned, middle ground that strikes an appropriate balance and does what we need it to do. It ends the problem of too-big-to-fail financial institutions, effectively regulates the derivatives products which some have referred to as financial weapons of mass destruction, and it greatly strengthens investor protections. It also regulates many more actors in our financial markets, establishes a Federal resource center on insurance issues, and holds rating agencies accountable for their actions. In sum, Mr. Speaker, I support this bill and urge my colleagues to vote for it.

Congressman Peterson – Treatment of End Users Under Title VII

Mr. FRANK of Massachusetts. I yield 1 minute to my colleague, the gentleman from Minnesota (Mr. Peterson), the chairman of the Agriculture Committee.

Mr. PETERSON. Mr. Speaker, I would like to enter into the Record a letter that Chairman Frank and I received from Chairmen Lincoln and Dodd on the treatment of end users under the derivatives title of the bill. As the letter makes clear, we have given the regulators no authority to impose margin requirements on anyone who is not a swap dealer or a major swap participant.

While the regulators do have authority over the dealer or MSP side of a transaction, we expect the level of margin required will be minimal, in keeping with the greater capital that such dealers and MSPs will be required to hold. That margin will be important, however, to ensure that the dealer or major stock participant will be capable of meeting their obligations to the end users. We need to make sure that they have that backing.

I would also note that few, if any, end users will be major swap participants, as we have excluded "positions held for hedging or mitigating commercial risk" from being considered as a "substantial position" under that definition.

I would ask Chairman Frank whether he concurs with my view of the bill.

The SPEAKER pro tempore. The time of the gentleman has expired.

Mr. FRANK of Massachusetts. I yield the gentleman 15 additional seconds.

And the gentleman is absolutely right. We do differentiate between end users and others. The marginal requirements are not on end users. They are only on the financial and major swap participants. And they are permissive. They are not mandatory, and they are going to be done, I think, with an appropriate touch.

U.S. Senate, Washington, DC

June 30, 2010.

Hon. Chairman Barney Frank
Financial Services Committee
House of Representatives
Rayburn House Office Building
Washington, DC.

Hon. Chairman Collin Peterson
Committee on Agriculture
House of Representatives
Longworth House Office Building
Washington, DC.

Dear Chairmen Frank and Peterson:

Whether swaps are used by an airline hedging its fuel costs or a global manufacturing company hedging interest rate risk, derivatives are an important tool businesses use to manage costs and market volatility. This legislation will preserve that tool.

Regulators, namely the Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission (SEC), and the prudential regulators, must not make hedging so costly it becomes prohibitively expensive for end users to manage their risk. This letter seeks to provide some additional background on legislative intent on some, but not all, of the various sections of Title VII of H.R. 4173, the Dodd-Frank Act.

The legislation does not authorize the regulators to impose margin on end users, those exempt entities that use swaps to hedge or mitigate commercial risk. If regulators raise the costs of end user transactions, they may create more risk. It is imperative that the regulators do not unnecessarily divert working capital from our economy into margin accounts, in a way that would discourage hedging by end users or impair economic growth.

Again, Congress clearly stated in this bill that the margin and capital requirements are not to be imposed on end users, nor can the regulators require clearing for end user trades.

Regulators are charged with establishing rules for the capital requirements, as well as the margin requirements for all uncleared trades, but rules may not be set in a way that requires the imposition of margin requirements on the end user side of a lawful transaction. In cases where a Swap Dealer enters into an uncleared swap with an end user, margin on the dealer side of the transaction should reflect the counterparty risk of the transaction. Congress strongly encourages regulators to establish margin requirements for such swaps or security-based swaps in a manner that is consistent with the Congressional intent to protect end users from burdensome costs.

In harmonizing the different approaches taken by the House and Senate in their respective derivatives titles, a number of provisions were deleted by the Conference Committee to avoid redundancy and to streamline the regulatory framework.

However, a consistent Congressional directive throughout all drafts of this legislation, and in Congressional debate, has been to protect end users from burdensome costs associated with margin requirements and mandatory clearing. Accordingly, changes made in Conference to the section of the bill regulating capital and margin requirements for Swap Dealers and Major Swap Participants should not be construed as changing this important Congressional interest in protecting end users. In fact, the House offer amending the capital and margin provisions of Sections 731 and 764 expressly stated that the strike to the base text was made “to eliminate redundancy.” Capital and margin standards should be set to mitigate risk in our financial system, not punish those who are trying to hedge their own commercial risk.

Congress recognized that the individualized credit arrangements worked out between counterparties in a bilateral transaction can be important components of business risk management. That is why Congress specifically mandates that regulators permit the use of non-cash collateral for counterparty arrangements with Swap Dealers and Major Swap Participants to permit flexibility. Mitigating risk is one of the most important reasons for passing this legislation.

Congress determined that clearing is at the heart of reform—bringing transactions and counterparties into a robust, conservative and transparent risk management framework. Congress also acknowledged that clearing may not be suitable for every transaction or every counterparty. End users who hedge their risks may find it challenging to use a standard derivative contracts to exactly match up their risks with counterparties willing to purchase their specific exposures. Standardized derivative contracts may not be suitable for every transaction. Congress recognized that imposing the clearing and exchange trading requirement on commercial end-users could raise transaction costs where there is a substantial public interest in keeping such costs low (i.e., to provide consumers with stable, low prices, promote investment, and create jobs.)

Congress recognized this concern and created a robust end user clearing exemption for those entities that are using the swaps market to hedge or mitigate commercial risk. These entities could be anything ranging from car companies to airlines or energy companies who produce and distribute power to farm machinery manufacturers. They also include captive finance affiliates, finance arms that are hedging in support of manufacturing or other commercial companies. The end user exemption also may apply to our smaller financial entities—credit unions, community banks, and farm credit institutions.

These entities did not get us into this crisis and should not be punished for Wall Street's excesses. They help to finance jobs and provide lending for communities all across this nation. That is why Congress provided regulators the authority to exempt these institutions.

This is also why we narrowed the scope of the Swap Dealer and Major Swap Participant definitions. We should not inadvertently pull in entities that are appropriately managing their risk. In implementing the Swap Dealer and Major Swap Participant provisions, Congress expects the regulators to maintain through rulemaking that the definition of Major Swap Participant does not capture companies simply because they use swaps to hedge risk in their ordinary course of business. Congress does not intend to regulate end-users as Major Swap Participants or Swap Dealers just because they use swaps to hedge or manage the commercial risks associated with their business. For example, the Major Swap Participant and Swap Dealer definitions are not intended to include an electric or gas utility that purchases commodities that are used either as a source of fuel to produce electricity or to supply gas to retail customers and that uses swaps to hedge or manage the commercial risks associated with its business.

Congress incorporated a de minimis exception to the Swap Dealer definition to ensure that smaller institutions that are responsibly managing their commercial risk are not inadvertently pulled into additional regulation.

Just as Congress has heard the end user community, regulators must carefully take into consideration the impact of regulation and capital and margin on these entities.

It is also imperative that regulators do not assume that all over-the-counter transactions share the same risk profile. While uncleared swaps should be looked at closely, regulators must carefully analyze the risk associated with cleared and uncleared swaps and apply that analysis when setting capital standards for Swap Dealers and Major Swap Participants. As regulators set capital and margin standards on Swap Dealers or Major Swap Participants, they must set the appropriate standards relative to the risks associated with trading. Regulators must carefully consider the potential burdens that Swap Dealers and Major Swap Participants may impose on end user counterparties—especially if those requirements will discourage the use of swaps by end users or harm economic growth. Regulators should seek to impose margins to the extent they are necessary to ensure the safety and soundness of the Swap Dealers and Major Swap Participants.

Congress determined that end users must be empowered in their counterparty relationships, especially relationships with swap dealers. This is why Congress explicitly gave to end users the option to clear swaps contracts, the option to choose their clearinghouse or clearing agency, and the option to segregate margin with an independent 3rd party custodian.

In implementing the derivatives title, Congress encourages the CFTC to clarify through rulemaking that the exclusion from the definition of swap for "any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled" is intended to be consistent with the forward contract exclusion that is currently in the Commodity Exchange Act and the CFTC's established policy and orders on this subject, including situations where commercial parties agree to "book-out" their physical delivery obligations under a forward contract.

Congress recognized that the capital and margin requirements in this bill could have an impact on swaps contracts currently in existence. For this reason, we provided legal certainty to those contracts currently in existence, providing that no contract could be terminated, renegotiated, modified, amended, or supplemented (unless otherwise specified in the contract) based on the implementation of any requirement in this Act, including requirements on Swap Dealers and Major Swap Participants. It is imperative that we provide certainty to these existing contracts for the sake of our economy and financial system.

Regulators must carefully follow Congressional intent in implementing this bill. While Congress may not have the expertise to set specific standards, we have laid out our criteria and guidelines for implementing reform. It is imperative that these standards are not punitive to the end users, that we encourage the management of commercial risk, and that we build a strong but responsive framework for regulating the derivatives market.

Sincerely,

Chairman Christopher Dodd,
Senate Committee on Banking, Housing, and Urban Affairs

U.S. Senate.
Chairman Blanche Lincoln
Senate Committee on Agriculture, Nutrition, and Forestry
U.S. Senate.

Congressman Pelosi – General Colloquy

Ms. PELOSI. I commend the gentleman for his great leadership, and I thank him for yielding time.

Mr. Speaker, as I listened to the debate here, I can't help but remember, and I have a vivid memory of it, a couple of years ago, almost 2 years ago, September 18, a Thursday afternoon, we were gathered in our office, and had just seen in the week and a half preceding, a week and a half to 2 weeks preceding that day, some unusual events that related to Lehman Brothers, Merrill Lynch, and then AIG and the Fed bailout of AIG.

I called the Secretary of the Treasury and said, We are meeting here in my office, and wondered if we could be helpful in any way in terms of public policy, because what we seem to see coming out from the executive branch is chaos. Different responses to different challenges that were not adding up to us. Could you, Mr. Secretary, come to the Congress tomorrow and give us a report on what is happening? And I said could you be here at 9 o'clock tomorrow morning to tell us what is happening to the markets? Secretary Paulson said, "Madam Speaker, tomorrow morning will be too late." Tomorrow morning will be too late. "Why, Mr. Secretary, have you not notified Congress? Why have you not called us sooner? Why would it take a call from me to ask you to report to us to tell us that tomorrow morning will be too late?"

Without going into his response, which I am happy to do, but in the interests of time I won't now, I then called the Chairman of the Fed, Chairman Bernanke, and asked him to join the Secretary of the Treasury at my office later that day.

The meeting turned into a meeting that was House and Senate, Democrats and Republicans gathered together to hear from the Secretary of the Treasury the condition of the markets. The Secretary, who had told us that we couldn't even wait until the next morning, described a very, very grim situation.

The chairman of the Fed, who was an expert on the Great Depression, told us that the situation was so grim that if we did not act immediately, there would be no economy by Monday. This is Thursday night. There would be no economy by Monday. How could it be? We, the greatest country in the world with the strongest economy, yet we needed to act immediately.

The response from the Bush administration was a bailout of the banks. And at a 24-hour/48-hour period they produced a bill, $700 billion, that they asked the Congress to pass to bail out the banks. It was necessary to do because of the recklessness of the Bush administration's economic policy, because of the lack of supervision, discipline, regulation. The recklessness on Wall Street had taken us to the brink of a financial crisis of such magnitude that the chairman said there wouldn't be an economy by Monday.

Took us into deep recession where 8-1/2 million jobs were lost. People lost their jobs, therefore in many cases their health insurance. They lost their pensions, they lost their savings, they had to live off savings, and they lost their investments for their children's education. Because of recklessness on Wall Street, joblessness was rampant on Main Street.

One of the reasons was there was no credit. It's interesting to hear my colleagues talk about the importance of credit to Main Street, but not one of them voted for the Small Business Credit bill that passed in this Congress about a week ago.

But in any event, joblessness, lack of credit, suppressing the entrepreneurial spirit of the United States of America, because there were some, not all, but some on Wall Street who decided it was okay to privatize the game as long as they were making money and nationalize the risk. Send the bill to the taxpayer when they were not. That's why we are here today to make sure that never happens again, to say to them that the party is now over.

And it's interesting to note that in that message, not one Republican participated when this bill came to the floor originally. And that was the end of last year. Years of allowing Wall Street to do anything it wants, beyond *laissez faire*, to be overleveraged, no transparency, no accountability, produce the most severe financial crisis and economic downturn since the Great Depression—and the American people paid the price.

Again, 8 million jobs, nearly $17 trillion in net worth disappeared. A record number of foreclosures ravaged our communities. And, again, credit disappeared from small businesses. This also had a tremendous impact on construction in our country because of the lack of loans.

Today, I rise with the clear message that the party is over. No longer again will recklessness on Wall Street cause joblessness on Main Street. No longer will the risky behavior of a few threaten the financial stability of our families, our businesses, and our economy as a whole.

The Wall Street Reform and Consumer Protection Act has been appropriately named for Chairman Dodd and Chairman Frank, and I thank them for their leadership. In doing so, in bringing this legislation before the Congress, Chairman Frank and Chairman Dodd are making history. For decades to come their names will be identified with historic reforms to protect the economy of our country and the financial and economic security of the American people.

I also want to acknowledge Chairman Collin Peterson who carefully negotiated some of the most contentious positions of this legislation working with Chairwoman Lincoln on the Senate side. All of the Democratic conferees, I thank you for your commitment for making the strongest bill possible and for always putting America's consumers first.

Today we will follow the lead of those on the committee enacting historic legislation to bring transparency to our financial markets, lowering the leverage that got us into this trouble in the first place, bringing tough oversight to Wall Street, and bringing consumer protection to Main Street and to the American people.

By voting "yes," we will pass the toughest set of Wall Street reforms in generations. This comprehensive and far-reaching legislation injects transparency and accountability as it lowers leverage and to the financial system run amok under the Republicans' reckless economic policies.

This legislation makes commonsense reforms that end the era of taxpayer bailouts and "too big to fail" financial firms. It establishes a new independent agency solely dedicated to protecting Americans from anticonsumer abuses. The bill closes the door on predatory lending and regulates payday lenders. It includes provisions to allow us to conduct oversight over the Fed, establishes tough rules for risky financial practices, enhances oversight for credit rating agencies, and reins in egregious CEO bonuses by giving shareholders a say on executive pay.

It sheds light on the darkest corners of the derivatives market and is fully paid for. And how is it paid for? By shutting down the Bush-era bailout fund known as the TARP and using the savings for financial reform.

As we cast our votes today, each Member of this body faces a choice. We have had these choices before. Democrats wanted to rein in health insurance companies; the Republicans said no. Democrats wanted to rein in Big Oil; the Republicans said no. Democrats want to rein in the recklessness of some on Wall Street; the Republicans are saying no.

Each Member of this body will have a choice. We can place our bet on the side of those on Wall Street who have gambled with our savings and lost, or we can stand with Main Street and the middle class. Will we preserve a status quo? And if this bill were to fail, we would be preserving a status quo that has left our economy in a wretched state. Or will we guarantee the American people strong reforms and effective vigilance to prevent another financial crisis?

How can we possibly resist the change that must happen? How can we forget that the chairman of the Fed said if we do not act, we will not have an economy by Monday—4 days from when we were having the conversation? How can we let the status quo that created that condition to continue?

I urge my colleagues to choose on the side of Main Street. I urge you to build a future of stability and security for America's families, consumers, and small businesses. I urge you to vote "aye" on the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Congressman Frank – General Colloquy

Mr. FRANK of Massachusetts. Mr. Speaker, to begin, I want to address the Members who are concerned that the interchange amendments will unduly affect smaller financial institutions. The interchange amendment wasn't part of the bill here. It was put in by a very heavy vote in the Senate, and the conference process means you compromise.

There is in that amendment, as Senator Durbin put it in, an exemption for any fee setting by the Federal Reserve for smaller institutions. They then feared that they would be discriminated against, so we amended the amendment with the participation of the Senate, obviously. There are three provisions that protect the smaller institutions, community banks and credit unions.

There is an antidiscrimination provision that says that merchants and retailers cannot refuse to accept a debit card. There can be no discrimination against small banks for their credit cards. The Federal Reserve, the instructions to the Federal Reserve, include making that antidiscrimination work, and we can guarantee people we will do it.

So, yes, as the amendment passed the Senate, it said that these smaller institutions were exempt but that they might have suffered discrimination. They are protected in this bill. That's why, for instance, the small banks in Illinois have endorsed this bill.

I also want to talk briefly about what has happened with the TARP. We had the two last Republican speakers. One hailed the CBO as an unassailable authority. Then the final speaker said it was hocus-pocus. It is apparently unassailable hocus-pocus, which I don't want to get into. It's too late at this time.

This is how the TARP thing works. There are two parts to the TARP. The bill does say that repayments go to debt relief. There have been substantial repayments from the banks, and those go to debt relief. They are unaffected by the amendment. What the amendment says is there are still tens of billions of dollars of TARP money that could be committed. The amendment we adopted in conference says no more, that they cannot do that. That's where the savings comes. So the savings comes from not allowing additional TARP spending.

You know about the Republicans with regard to cutting off TARP? They were for it before they were against it. They used to be all for cutting out the TARP until it came up here. Now, let me say I don't like that way to do it. I prefer what we had in our provision, which was to assess the Goldman Sachs, JPMorgan Chase, Mr. Paulson's hedge fund. That's the way we wanted to do it, but we couldn't get it through the Republicans in the Senate. So, first, Republicans in the Senate tell us, Don't do it. Then other Republicans in the Senate say, Why didn't you do it?

So I'll make Members a pledge right now: The committee I chair will, I hope, bring out a bill that revives that assessment on the financial institutions above $50 billion and the hedge funds. So Members who missed it will get a chance to show us they really care. We will bring them there, and we will have that come forward.

Now, I do want to talk a little bit about subprime lending and about the partial history we get.

The fact is that the Republican Party controlled the House and the Senate from 1995 to 2006. During that period, they showed remarkable restraint. As eager as they were to restrain subprime lending and as passionate as they were to reform Fannie Mae and Freddie Mac, they didn't do it. That's a degree of abstinence unparalleled in political history. They were in charge.

Whose fault was it? Apparently, it was our fault. It was my fault. As I said before, people have accused me of being this secret manipulator of Tom DeLay. Well, if that were the case, you wouldn't have cut taxes for very rich people. You wouldn't have gone to war in Iraq. As I said, if he were listening to me, he wouldn't have gotten on the dance show. So I don't take responsibility for Mr. DeLay. The Republican Party didn't do it.

Now, the gentleman from California (Mr. Royce) said he tried in 2005. He had an amendment to the bill of Mr. Oxley. Mr. Oxley, the Republican chairman of the committee, brought out a bill. Mr. Royce didn't like it. He brought up his amendments. If no Democrat had voted either in committee or on the floor of the House on that bill, it would have looked exactly as it looked. The majority was Republican. So, apparently, the gentleman from California (Mr. Royce) wasn't able to persuade even a third of his fellow Republicans to vote with him.

I'm sorry he wasn't able to do better. I'm not an expert in how to get Republicans to vote with you, so I can't offer him any help. Maybe he can find somebody who can teach him how to get better votes among Republicans, but it's not our fault that the Republican Party didn't do it.

By the way, in 2003, I did say I didn't see a problem with Fannie Mae and Freddie Mac. Then, in 2004, President Bush said to Fannie Mae and Freddie Mac, I order you. He had the power and he used it. He used it to order them to increase their subprime lending purchases. By the way, he wasn't alone in that. A June 22 article from the Wall Street Journal quotes a Member of Congress, in 2005, at a hearing, saying, "With the advent of subprime lending, countless families have now had their first opportunity to buy a home or perhaps be given a second chance." Fail once. Get it again.

The American Dream should never be limited to the well-offs or to those consumers fortunate enough to have access to prime rate loans. That is from the gentleman from Texas (Mr. Hensarling). So George Bush wasn't alone in that.

Then 2007 came, and the Democrats took power. We passed a bill, for the first time in this House, to regulate Fannie Mae and Freddie Mac. Secretary Paulson liked the bill. He said it didn't go as far as he would have liked, but it was a good bill. In 2008, it finally passed, and Fannie Mae and Freddie Mac were put in a conservatorship. They were the first major institutions to be reformed.

By the way, in 2007, in this House, we also passed a bill to control subprime lending. Now, the gentleman from Alabama had been the chairman of the subcommittee with jurisdiction over subprime lending during some of those Republican years, and he never produced a bill. He said it was our fault. He wrote us a letter—myself, Mr. Watt of North Carolina, and Mr. Miller of North Carolina—and we didn't tell him we'd vote for it.

You know, I wish I could have it back. I wish I knew I was secretly in charge of the Republican agenda. I wish I knew they wouldn't do anything unless I said they could and that they would do something if I said they should, but no one told me. Where were they when I needed them to be more powerful? He didn't bring it forward. It wasn't my fault. The Republicans never checked with me as to what they were supposed to do.

In 2007, we did pass such a bill to restrict subprime lending, and The Wall Street Journal attacked us. It said it was a "Sarbanes-Oxley" for housing. Sarbanes-Oxley is about as nasty as you can get in The Wall Street Journal, and here is what they said about subprime lending in 2007.

So maybe that is why George Bush expanded subprime lending.

The Wall Street Journal said in 2007, complaining about our bill, "But for all the demonizing, about 80 percent of even subprime loans are being repaid on time and another 10 percent are only 30 days behind. Most of these new homeowners are low-income families, often minorities, who would otherwise not have qualified for a mortgage. In the name of consumer protection, Mr. Frank's legislation will ensure that far fewer of these loans are issued in the future."

Yeah. Unfortunately, a couple of years too late, because we couldn't get that through. But the Wall Street Journal was right, we would limit them, but wrong, along with the gentleman from Texas (Mr. Hensarling) about the subprime loans. And I also wanted to do affordable rental housing, which that administration opposed.

This bill has the biggest package of increased consumer protections in the history of America. And it doesn't ban products or ration products. It says there is going to have to be fair dealing. This bill says that there is a fiduciary responsibility on people selling products to individual investors for the first time. It gives the SEC the power to do it, and they are going to do it. This bill reforms the system, and I hope it is enacted.

This conference report would not have been possible without the hard work of staff on both sides of the Capitol. I thank them for their efforts and submit the following list:

Wall Street Reform—Staff
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House Agriculture Committee

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House Budget Committee
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House Judiciary Committee
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Baird Webel

Congressman Peterson – Title VII Jurisdictional Issues

Mr. PETERSON. Mr. Speaker, I rise today to discuss some of the jurisdictional issues that arise out of Title VII of H.R. 4173. The bill brings a new regulatory regime to swaps as it will be defined under the Commodity Exchange Act, CEA. Title VII of H.R. 4173 extends the Commodity Futures Trading Commission's, CFTC's, exclusive jurisdiction under the CEA to also include swaps, except as otherwise provided elsewhere in Title VII. Also included in Title VII are two savings clauses for the Securities and Exchange Commission, SEC, and one for the Federal Energy Regulatory Commission, FERC.

Title VII allocates authority over swaps and security-based swaps as follows. First, the CFTC has exclusive jurisdiction over swaps, including swaps on broad-based security indexes. Within the swap definition is a category of swaps called security-based swap agreements. For this specific category of swaps, the CFTC will continue to exercise its full jurisdictional authority, while the SEC may exercise certain specific authorities over these products, as outlined in Title VII. Title VII also clarifies that the SEC has jurisdiction over security-based swaps, which are swaps on narrow-based security indexes and single securities, and that the two agencies share authority over mixed swaps.

Nothing in the SEC savings clauses, or any other provision of Title VII, alters the existing jurisdictional divide between the CFTC and SEC established by the Johnson-Shad Accord which, among other things, provides the CFTC exclusive jurisdiction over futures (and options on futures) on broad-based security indexes. Nor do these savings clauses, or any other provision of Title VII, divest or limit the authority that the CFTC shares with the SEC over security futures products as authorized by the Commodity Futures Modernization Act of 2000.

This bill also clarifies the authorities of the CFTC and FERC over financial instruments—both swaps and futures—traded pursuant to FERC or state approved tariffs or rate schedules.

Section 722 preserves FERC's existing authorities over financial instruments traded pursuant to a FERC or state approved tariff or rate schedule, which under current law does not extend to CFTC-regulated exchanges and clearinghouses, because these are within CFTC's exclusive jurisdiction. The CFTC's authorities over futures and swaps traded pursuant to FERC or state approved tariffs or rate schedules are also fully preserved. The bill further specifies that, outside of regional transmission organizations/independent system operators (RTOs/ISOs) markets, the CFTC shall continue to have exclusive jurisdiction over financial instruments traded on CFTC-regulated exchanges, such as NYMEX or ICE, traded through swap execution facilities, or cleared on CFTC-regulated clearinghouses.

To avoid the potential for overlapping or duplicative FERC and CFTC authority, the bill provides the CFTC with the authority to exempt financial instruments traded within an RTO/ISO from CFTC regulation if the CFTC determines the exemption would be consistent with the public interest and the purposes of the Commodity Exchange Act.

Section 722 also preserves FERC's anti-manipulation authority as it currently exists under the Federal Power Act and the Natural Gas Act prior to enactment of this legislation.

Congressman Hastings – Short Term Credit Products

Mr. HASTINGS of Florida. Mr. Speaker, I want to commend Chairman Frank on an extraordinary effort and for his dedicated leadership in bringing this bill to the floor. I look forward to supporting this legislation.

Before that however, I would like to clarify a few points as they pertain to the intent of this bill.

It is my understanding that certain provisions which are intended to improve access to mainstream financial institutions are not intended to further limit access to credit and other financial services to the very consumers who are already underserved by traditional banking institutions.

As the Chairman knows, each year, over 20 million working American families with depository account relationships at federally insured financial institutions actively choose alternative sources and lenders to meet their emergency and short-term credit needs.

These alternative sources and lenders often offer more convenient and less expensive products and services than the banks or credit unions where these consumers have relationships.

Further, as the demand for short-term, small-dollar loans continues to increase as a result of the current economic environment, non-traditional lenders have filled the void left by mainstream financial institutions in many of our nation's underbanked communities.

I agree with the Chairman that lenders should meet this demand responsibly with clear, well-disclosed product terms and conditions that do not encourage consumer dependence and indebtedness.

I would also stress that regulation of this sector of the market should ensure strong consumer protections while encouraging a broad range of product offerings without discrimination as to the type of lender.

Therefore, regulation of short-term credit products and of the lenders who offer them, whether they be traditional financial institutions or non-traditional lenders, should not be used to single out an entire sector.

Rather, it should be well-balanced and carried out in a manner that encourages consumer choice, market competition, and strong protections.

It is my sincere hope that this legislation is designed to carefully and fairly police the financial services industry, treating similar products in the short-term credit market equally while encouraging lending practices that are fair to consumers. Is this the intent of the legislation?

I thank the Chairman, commend his continued efforts to pass meaningful financial regulatory reform this Congress, and thank him for his previous efforts to ensure we responsibly address the role of non-traditional financial institutions. I look forward to continuing our work together in this matter and as we further our efforts to put our nation back on solid financial footing.