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
House Financial Services Committee
Jeanne Roslanowick
Michael Beresik
David Smith
Adrianne Threatt
Andrew Miller
Daniel Meade
Katheryn Rosen
Kate Marks
Kellie Larkin
Tom Glassic
Rick Maurano

Tom Duncan
Gail Laster
Scott Olson
Lawranne Stewart
Jeff Riley
Steve Hall
Erika Jeffers
Bill Zavarello
Steve Adamske
Elizabeth Esfahani
Daniel McGlinchey
Dennis Shaul
Jim Segal
Brendan Woodbury
Patty Lord
Lois Richerson
Jean Carroll
Kirk Schwarzbach
Marcos Manosalvas
Marcus Goodman
Garett Rose
Todd Harper
Kathleen Mellody
Jason Pitcock
Charla Ouertatani
Amanda Fischer
Keo Chea
Sanders Adu
Hilary West
Flavio Cumpiano
Karl Haddeland
Glen Sears
Stephane LeBouder

Office of Rep. Carolyn Maloney
Kristin Richardson

Office of Rep. Gregory Meeks
Milan Dalal

Office of Rep. Mary Jo Kilroy
Noah Cuttler

Office of Rep. Gary Peters
Jonathan Smith

House Agriculture Committee

Clark Ogilvie

House Budget Committee
Greg Waring

House Energy and Commerce Committee
Phil Barnett
Michelle Ash
Anna Laitin

House Judiciary Committee
George Slover

House Oversight and Government Reform Committee
Mark Stephenson
Adam Miles

House Legislative Counsel
Jim Wert
Marshall Barksdale
Brady Young
Jim Grossman

Senate Banking Committee
Ed Silverman
Amy Friend
Jonathan Miller
Dean Shahinian
Julie Chon
Charles Yi
Marc Jarsulic
Lynsey Graham Rea
Catherine Galicia
Matthew Green
Deborah Katz
Mark Jickling
Donna Nordenberg
Levon Bagramian
Brian Filipowich
Drew Colbert
Misha Mintz-Roth
Lisa Frumin
William Fields
Beth Cooper
Colin McGinnis
Neal Orringer
Kirstin Brost

Peter Bondi
Sean Oblack
Steve Gerenscer
Dawn Ratliff
Erika Lee
Joslyn Hemler
Caroline Cook
Robert Courtney
Abigail Dosoretz

Senate Agriculture Committee
Robert Holifield
Brian Baenig
Julie Anna Potts
Pat McCarty
George Wilder
Matt Dunn
Elizabeth Ritter
Stephanie Mercier
Anna Taylor
Cory Claussen

Senate Legislative Counsel
Rob Grant
Alison Wright
Kim Albrecht-Taylor
Colin Campbell
Laura McNulty Ayoud

Congressional Research Service
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.