FINANCIAL REFORM: 2010

Preparing for the House-Senate Conference on H.R. 4173

A Summary of S. 3217, the Restoring American Financial Stability Act of 2010, As Passed By the U.S. Senate on May 20, 2010

**WITH REFERENCE TO H.R. 4173,
THE WALL STREET REFORM AND CONSUMER PROTECTION ACT OF 2009,
AS PASSED BY THE U.S. HOUSE OF REPRESENTATIVES ON DECEMBER 11, 2009**

Working Summary No. 2

REPORT ON FINANCIAL INSTITUTIONS

Gibson, Dunn & Crutcher LLP
www.gibsondunn.com

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Editor's Note:

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

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

C.F. Muckenfuss, III
(202) 955-8514
cmuckenfuss@gibsondunn.com

Michael Bopp
(202) 955-8256
mbopp@gibsondunn.com

Michael A. Rosenthal
(212) 351-3968
mrosenthal@gibsondunn.com

Kimble C. Cannon
(213) 229-7084
kcannon@gibsondunn.com

Janet Weiss
(212) 351-3988
jweiss@gibsondunn.com

Robert C. Eager*

Caeli Higney
(202) 955-8542
chigney@gibsondunn.com

Adam Chen
(212) 351-2327
achen@gibsondunn.com

Travis Souza
(214) 698-3416
tsouza@gibsondunn.com

Michael Aaron Titera
(213) 229-7559
mtitera@gibsondunn.com

Nikesh Jindal
(202) 887-3695
njindal@gibsondunn.com

Amanda H. Neely
(202) 955-8232
aneely@gibsondunn.com

Aditi A. Prabhu
(202) 955-8252
aprabhu@gibsondunn.com

Kelly Ann Shaw
(202) 887-3731
kshaw@gibsondunn.com

Meredith C. Shaughnessy
(213) 229-7857
mshaughnessy@gibsondunn.com

* Principal, Potomac Banking Consulting; Retired Former Partner, Gibson, Dunn & Crutcher LLP – (202) 329-4897, *reager@retiredpartner.gibsondunn.com*.

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INTRODUCTION

A. Financial Reform Legislation Since 2009

Administration. Financial reform legislation recently passed by the United States Senate is the latest in a series of financial reform efforts that began in June 2009 when the Department of the Treasury released a white paper entitled "Financial Regulatory Reform - A New Foundation: Rebuilding Financial Supervision and Regulation". That paper discussed the Obama Administration's ("Administration's") financial reform proposals, proposals that were based on the belief that inadequate and inconsistent regulation of the largest financial firms contributed significantly to the financial crisis that struck both the United States and the global economy beginning in early 2007. The Administration subsequently proposed a series of bills to reform the financial system.

House. The House Financial Services Committee acted next, introducing a proposal based on the Administration's ideas. As subsequently passed by the House as H.R. 4173, the Wall Street Reform and Consumer Protection Act, in December 2009, this legislation followed the Administration's approach in many respects but diverged from it in other ways.

Senate. On March 22, 2010, a bill seeking general reform of financial industry regulation in response to the recent financial crisis was adopted on a party-line vote by the Senate Banking Committee Chaired by Senator Christopher Dodd. This bill, the "Restoring American Financial Stability Act of 2010" (the "Senate Bill"), was subsequently reported to the full Senate as S. 3217. Thereafter, the Senate Agricultural Committee, Chaired by Senator Blanche Lincoln, adopted along party lines the "Wall Street Transparency and Accountability Act of 2010", comprising a revised derivatives title. This derivatives title was substituted for Title VII of the RAFSA and submitted to the full Senate as the Dodd-Lincoln substitute amendment, S.A. 3739.

On May 20, 2010, the Senate passed the Senate Bill with 31 amendments,[1] in addition to the replacement derivatives titled included in the Dodd-Lincoln substitute amendment. Upon passage, under pertinent Congressional rules, the bill was given the same number as the House-passed bill, H.R. 4173.

B. Senate – House Conference Process

Differences between the House Bill and the Senate Bill will be addressed in formal reconciliation conference with a single bill being reported back to both houses at the conclusion of that process. While the final version of the bill will require approval by a simple majority of both the House of Representatives and the Senate, the conference report can be filibustered in the Senate, with the result that 60 votes will be required there before the measure can be voted on by

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[1] There were 31 amendments introduced and adopted by the Senate in addition to the Dodd-Lincoln substitute amending the Bill to include a revised derivatives title, Title VII. Attached at Appendix A is a chart listing each of these 31 additional amendments.

the Senate. Only a Conference Report agreed to by both houses can be sent to the President to be signed into law.

The following timeline for moving the bill through conference has been released:

- Tuesday, June 8th - conferees appointed
- Wednesday, June 9th - first open meeting of the conference; organizational matters and opening statements
- Tuesday, June 15th through Thursday, June 17th - conference meets on substantive issues
- Tuesday, June 22nd, Wednesday, June 23rd-conference meets on substantive issues
- Thursday, June 24th - conference concludes with formal signing ceremony; conference report filed shortly thereafter
- Monday, June 28th - Rules Committee meets
- Tuesday, June 29th - House passes conference report
- Senate has three days to pass the bill before the beginning of the July 4th recess

The following Senators have been named as conferees: from the Banking Committee: Chairman Christopher Dodd (CT), Tim Johnson (SD), Jack Reed (RI), Charles Schumer (NY), Ranking Minority Member Richard Shelby (AL), Bob Corker (TN), Mike Crapo (ID), and Judd Gregg (NH); and from the Agriculture Committee, Chairman Blanche Lincoln (AR), Patrick Leahy (VT), Tom Harkin (IA), and Saxby Chambliss (GA).

In addition, House Banking Committee Chairman Barney Frank has recommended the following House members as conferees for the majority: Chairman Barney Frank (MA), Carolyn Maloney (NY), Paul E. Kanjorski (PA), Luis V. Gutierrez (IL), Maxine Waters (CA), Melvin L. Watt (NC), Gregory W. Meeks (NY), and Dennis Moore (KS). Five conferees are yet to be identified for the minority Republicans.

The conference process is designed to reconciled differences between similar but not identical House and Senate legislative drafts. However, in this case because the Senate struck the entirety of the House-passed bill and replaced it with its own bill, every provision of the bill can be reconsidered during the conference and therefore technically is subject to change. It is expected that informal negotiations among key conferees will develop the final provisions to be considered for adoption by the conferees in formal sessions.

C. Senate Bill Overview

The final May 20, 2010, Senate Bill would, among other things, do the following:

- Establish a "Financial Stability Oversight Council" focused on identifying and monitoring systemic risks posed by financial firms and financial activities;

- Expand the Fed's powers over the largest financial firms and enhance regulation of all depository institution holding companies, including capital requirements;

- Subject large bank holding companies and systemically significant nonbank financial companies to stricter prudential standards;

- Create a new process for resolving failing financial companies that could cause systemic instability;

- Abolish the Office of Thrift Supervision (OTS), prohibit new thrift charters; transfer to the Office of the Comptroller of the Currency (OCC) authority over federal thrifts and transfer to the Fed authority over thrift holding companies;

- Increase regulation of hedge fund advisors;

- Introduce restrictions on proprietary trading and investing in hedge funds and private equity funds to depository institutions and their parent companies (the "Volcker" rules);

- Increase regulation of rating agencies;

- Enhance regulation of over-the-counter derivatives; and

- Create a new consumer financial products regulator housed inside the Federal Reserve.

D. Memorandum Features

The attached memorandum provides:

- A comprehensive summary of all the provisions of the Senate Bill as passed;

- A topical approach, following the bill titles in order; and

- Section and page number references to both the final print versions of the Senate and House bills in each paragraph.

TITLE I — FINANCIAL STABILITY

The Senate Bill seeks to increase financial marketplace transparency and stability by establishing a "Financial Stability Oversight Council" (the "Council") focused on identifying and monitoring systemic risks posed by financial firms and by financial activities and practices. By a two-thirds vote, the Council could determine which United States and foreign nonbank financial companies are to be subject to enhanced supervision by the Board of Governors of the Federal Reserve (the "Fed"), based on the perceived risk a company poses to financial stability in the United States. As amended, the Senate Bill provides that only those nonbank financial companies that are "predominantly engaged in" financial activities could be subject to such a determination under Section 113. The bill, however, also contains an "anti-evasion" provision that would allow the Council to designate a company that does not meet this requirement if the Council determines that the company is "organized or operates in such a manner as to evade" the application of Title I, and meets other specified requirements. Additionally, while only bank holding companies with over $50 billion in consolidated assets would be subject to more stringent prudential standards and reporting requirements under Title I of the bill, all bank holding companies would be subject to Fed supervision under Title III A new "Office of Financial Research" in the Treasury Department would provide the Council with technical expertise and data collection support services

Under Title I, the Fed would be responsible for setting stricter prudential standards that would apply to the nonbank financial companies subject to its supervision and to bank holding companies with assets of at least $50 billion. The Fed would have the authority to require reports from and conduct examinations of these companies, as well as apply early remediation requirements in the case of a company experiencing financial distress. If the Fed determines that such a large, complex company poses a grave threat to the financial stability of the United States it could—as a last resort and with a two-thirds vote of the Council—require such company to take mitigatory action such as divesting some of its holdings or selling assets.

The Council's authority would be somewhat restricted compared to its counterpart under the House Bill, H.R. 4173. For example, under the Senate Bill most significant actions by the Council, such as subjecting a nonbank financial company to the Fed's supervision, require a two-thirds vote including the affirmative vote of the Secretary of the Treasury, rather than a simple majority under H.R. 4173. Further, under H.R. 4173 the Council would have the potential authority to subject any bank holding company to stricter prudential regulations if it was deemed necessary to mitigate risk to the financial system, not just those with assets greater than $50 billion.

A. The Financial Stability Oversight Council

Under the Senate Bill, the Council's voting members would include the Secretary of the Treasury (as Chairperson), the Comptroller of the Currency, the Chairman of the Fed, the Chairman of the Securities and Exchange Commission, the Chairman of Commodity Futures Trading Commission, the Chairperson of the Federal Deposit Insurance Corporation, the Chairperson of the Federal Housing Finance Agency, and the head of the new Consumer Financial Protection Bureau, as well as independent member with insurance expertise appointed

by the President. The Director of the new Office of Financial Research would serve as the only nonvoting member. **Senate Bill § 111(b) (pp. 22-23); H.R. 4173 § 1001(b) (pp. 25-27).**[2]

The Senate Bill directs that the Council's expenses will be paid for by the Office of Financial Research, a newly established office within the Department of the Treasury. **Senate Bill § 118 (p. 56); H.R. 4173 § 1005(c) (p. 33).**

1. Functions of the Council

According to Title I, the purposes of the Council are threefold: (1) to identify risks to the financial stability of the United States that could arise from the material financial distress or failure of large, interconnected bank holding companies or nonbank financial companies; (2) to promote market discipline by eliminating shareholders', creditors', and counterparties' expectations that the government will shield them from losses in the event of failure; and (3) to respond to emerging threats to the stability of the United States financial markets. **Senate Bill § 112(a)(1) (pp. 26-27).**

In order to effectuate these goals, the Council would be tasked with the following duties:

- Collect information from member agencies and other federal and state financial regulatory agencies and, if necessary, direct the Office of Financial Research to collect information from bank holding companies and nonbank financial companies;

- Provide direction to, and request data and analyses from, the Office of Financial Research to support the Council's work;

- Monitor the financial services marketplace in order to identify potential threats to the financial stability of the United States;

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

- Recommend to the member agencies general supervisory priorities and principles reflecting the outcome of discussions among the member agencies;

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[2] Note that page number references to H.R. 4173 are to the version of the Wall Street Reform and Consumer Protection Act adopted by the House of Representatives on December 11, 2009. Where a citation to H.R. 4173 immediately follows a citation to the Senate Bill, this indicates that the House Bill contains a provision covering the same substantive issue or concern.

- Identify gaps in regulation posing risks to the financial stability of the United States;

- Require supervision by the Fed for nonbank financial companies that may pose risks to the financial stability of the United States in the event of their material financial distress or failure;

- Make recommendations to the Fed concerning the establishment of heightened prudential standards for risk-based capital, leverage, liquidity, contingent capital, resolution plans and credit exposure reports, concentration limits, enhanced public disclosures, and overall risk management for nonbank financial companies (and bank holding companies) supervised by the Fed;

- Identify systemically important financial market utilities and payment, clearing, and settlement activities, and require such utilities and activities to be subject to standards established by the Fed;

- Make recommendations to primary financial regulatory agencies to apply new or heightened standards and safeguards for financial activities or practices that could create or increase risks of significant liquidity, credit, or other problems spreading among bank holding companies, nonbank financial companies, and United States. financial markets;

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

- Annually report to and testify before Congress on (1) the Council's activities, (2) the significant financial market developments and potential emerging threats to financial stability, (3) all determinations made under § 113 or Title VIII, and (4) recommendations to enhance the integrity, efficiency, competitiveness, and stability of United States financial markets, to promote market disciple, and to maintain investor confidence. **Senate Bill § 112(a)(2) (pp. 27-30); H.R. 4173 § 1001(c) (pp. 27-29).**

Under the House Bill, most of the Council's functions would be the same, including the duty to identify those companies or financial activities that may pose systemic risk to the financial system.

The Council would meet at least quarterly, or more frequently as the Chairman deems necessary. All Council decisions would require approval by a majority of the voting members of the Council. **Senate Bill § 111(f) (p. 25).** The Senate Bill specifies specific circumstances, such as the determination that a nonbank company should be subject to the Fed's supervision, that would require a supermajority 2/3 vote, including the affirmative vote of the Council's chairperson, the Secretary of the Treasury. **Senate Bill § 113(a)(1) (p. 33).** The House Bill, in contrast, does not contain a similar supermajority voting provision; a simple majority vote would

be sufficient to subject a nonbank financial company to stricter prudential standards. **H.R. 4173 § 1004 (pp. 31-32).**

2. Reports to Congress

The Council would be required to annually report to and testify before Congress on: (1) the Council's activities, (2) the significant financial market developments and potential emerging threats to financial stability, (3) all determinations made under § 113 or Title VIII, and (4) recommendations to enhance the integrity, efficiency, competitiveness, and stability of United States financial markets, to promote market disciple, and to maintain investor confidence. **Senate Bill § 112(a)(2) (M) (pp. 29-30); H.R. 4173 § 1006(a).**

The House Bill goes farther than the Senate Bill, requiring that upon submission of the report to Congress each voting member of the Council also submit a signed statement indicating whether the member believes that the Council, the Government, and the private sector are taking all reasonable steps to ensure financial stability and to prevent systemic risk. If the member does not believe that such reasonable steps have been taken, the member must submit a signed statement indicating this belief and stating what actions he/she believes are necessary. **H.R. 4173 § 1006(c) (pp. 35-36)**.

Additionally, under the House Bill the Council is required to conduct a study of the effects that the regulations and standards of the newly-established Consumer Financial Protection Agency (CFPA) will have on all covered persons, [3] including non-depository institution covered persons. The study must include an evaluation and assessment of the appropriateness of using "APR" as a true measure of the value of all nonbank products. In addition, the Director of the CFPA must take the study's findings into account when issuing regulations and, within 240 days of H.R. 4173's enactment, must submit the study to Congress including any recommendations the Director has for changes in the law. **H.R. 4173 § 1007(e) (pp. 36-37).** Note that the Senate Bill does not contain a similar provision relating to conducting a study.

B. Office of Financial Research

1. Structure of the Office

Senate Bill § 152 would establish in the Treasury Department the Office of Financial Research (the "Office"), headed by a Director appointed by the President and confirmed by the Senate. **Senate Bill § 152(a) and (b)(1) (pp. 66-67).** The Director would serve for a 6 year term but could not simultaneously serve as head of any financial regulatory agency. **Senate Bill §§ 152(b)(2)-(3) (p. 67).** This section would further grant the Director authority to manage

[3] The term "covered person" means any person who engages directly or indirectly in a financial activity, in connection with the provision of a consumer financial product or service. It does not include the Secretary, the Department of Treasury, any agency or bureau under the jurisdiction of the Secretary or any person collecting Federal taxes for the United States to the extent such person is acting in such capacity. Section 4002(9).

personnel and to fix the number of Office employees. **Senate Bill §§ 152(b)(5) and (d)(1) (pp. 67-68).** The Director, in consultation with the Chairperson, would have authority to establish an annual budget for the Office. **Senate Bill § 152(c) (p. 67).** The Director would also have the independent authority to enter into contracts or acquire personal or real property (or property interest) that he or she determines necessary for carrying out the duties and responsibilities of the Office. **Senate Bill § 152(g)(1) (p. 69).**

The House Bill does not create an Office of Financial Research. Rather, the Council and the Board are authorized to receive, and can request the production of, any data or information from Council members that is necessary to fulfill the Council's specified duties or otherwise carry out any of the provisions of Title I of the House Bill. The Council may require the submission of reports from financial companies for the purpose of assessing the extent to which the company itself or its financial activities pose a threat to financial stability. **H.R. 4173 § 1101(a) (p. 40)**.

2. Purpose and Duties of the Office

The purpose of the Office would be to support the Council in fulfilling its purposes and duties and to support member agencies of the Council by:

- collecting data on behalf of the Council and providing such data to the Council and member agencies;
- standardizing the types and formats of data reported and collected;
- performing applied research and essential long-term research;
- developing tools for risk measurement and monitoring;
- performing other related services; and
- making the results of the activities of the Office available to financial regulatory agencies.

Senate Bill §§ 153(a)(1)-(6) (p. 71).

This section would further provide the Office with administrative and rulemaking authority regarding data collection and standardization. It would also require the Director provide additional reports and testify annually to Congress. **Senate Bill §§ 153(b)-(e) (pp. 71-74).**

3. Organizational Structure

Section 154 would establish within the Office a Data Center and a Research and Analysis Center with the authority to carry out programmatic responsibilities of the Office. **Senate Bill § 154(a) (p. 75).**

a) The Data Center

The Data Center would collect, validate, and maintain all data necessary to carry out its duties on behalf of the Council. The data assembled would be obtained from member agencies of the Council, commercial data providers, publicly available data sources, and financial entities. **Senate Bill § 154(b)(1) (p. 75).** The Office would also have authority to require the submission of periodic reports from any financial company for the purpose of assessing the extent to which a financial company, activity, or market poses a threat to the financial stability of the United States. **Senate Bill § 154(b)(1)(B)(i) (pp. 75-76).** Under this section, the Data Center would also be required to prepare and publish a financial company reference database, financial instrument reference database, and formats and standards for Office data. The Data Center would not be permitted to publish any confidential data. **Senate Bill § 154(b)(2) (pp. 76-77).**

b) The Research and Analysis Center

The Research and Analysis Center, on behalf of the Council, would be authorized to develop and maintain independent analytical capabilities and computing resources to:

- develop and maintain metrics and reporting systems for risks to the financial stability of the United States;
- monitor investigate, and report on changes in system-wide risk levels and patterns to the Council and Congress;
- conduct, coordinate, and sponsor research to support and improve regulation of financial entities and markets;
- evaluate and report on stress tests or other stability-related evaluations of financial entities overseen by the member agencies;
- maintain expertise in such areas as may be necessary to support specific requests for advice and assistance from financial regulators;
- investigate disruptions and failures in the financial markets, report findings, and make recommendations to the Council based on those findings;
- conduct studies and provide advice on the impact of policies related to systemic risk; and
- promote best practices for financial risk management

Senate Bill § 154(c) (pp. 78-79).

4. Reporting Responsibilities

Within two years of the enactment of the Senate Bill into law, and not later than 120 days after the end of each fiscal year thereafter, the Office would be required to submit a report to Congress that assesses the state of the United States financial system. This report should include

an analysis of any threats to the financial stability of the United States, the status of the efforts of the Office in meeting its mission, and key findings from the research and analysis of the financial system by the Office. **Senate Bill § 154(d) (pp. 79-80).**

5. Funding

The Office (and the Council) would be funded through assessments on nonbank financial companies supervised by the Fed and bank holding companies with total consolidated assets of $50 billion or more. **Senate Bill § 155(a) (pp. 80-81).** The Fed would be required to provide interim funding during the two-year period following the date of enactment of the Act, and subsequent to the two-year period, the Secretary of Treasury would be required to establish by regulation, and with the approval of the Council, an assessment schedule applicable to such companies that takes into account differences based on considerations for establishing prudential standards under § 115. **Senate Bill §§ 155(c)-(d) (p. 82).** To the extent that the assessment does not fully cover the expenses of the Office, the Fed would also be required to make up the funding shortfall. **Senate Bill § 155(d)(2) (p. 82).**

6. Transition Oversight

Section 156 aims to ensure that the Office has an orderly and organized startup, attracts and retains a qualified workforce, and establishes comprehensive employee training and benefits programs. **Senate Bill § 156(a) (p. 83).** To this end, the Office would be required to submit an annual report to the Senate Banking Committee and the House Financial Services Committee that includes a training and workforce development plan, workplace flexibilities plan, and recruitment and retention plan. **Senate Bill §§ 156(b)(1)-(2) (pp. 83-85).** The reporting requirement would terminate five years after the enactment of this Act. **Senate Bill § 156(c) (p. 85).**

C. Companies and Activities Subject to Stricter Prudential Standards

1. Scope of Companies Potentially Subject to Stricter Prudential Standards

Senate Bill

Under the Senate Bill, all bank holding companies with assets over $50 billion would (initially) be subject to enhanced standards under § 115. (The Fed would have the authority to raise, but not lower, that threshold amount.)

Senate Bill § 113 would authorize the Council to subject a nonbank financial company to stricter prudential standards if it determines that material financial distress at the company would pose a threat to the financial stability of the United States. Such a determination would require a 2/3 vote of the Council members, including an affirmative vote by the Chairperson (the Secretary of the Treasury), and result in the supervision of the nonbank financial company by the Fed. **Senate Bill §§ 113(a)(1)-(2) (pp. 33-35); H.R. 4173 § 1103(a) (pp. 46-47).**

However, under an amendment proposed by Senator Vitter (R-LA) and adopted by the Senate as revised by Senator Pryor (D-Ark), the Fed will no longer have the authority to

establish such criteria. Rather, the definition of "nonbank financial companies" will be limited to those that are "predominantly engaged in financial activities." A company will be considered "predominantly engaged in financial activities" if either (1) the annual gross revenues derived by the companies and all of its subsidiaries that are financial in nature (as defined in Section 4(k) of the BHC Act) or are incidental to a financial activity and, if applicable, related to the ownership or control of one or more insured depository institutions, represent 85 percent or more of the consolidated assets of the company or (2) the consolidated assets of the company and all of its subsidiaries related to activities that are financial in nature (as defined in Section 4(k) of the BHC Act) and, if applicable, related to the ownership or control of one of more insured depository institutions, represents 85% or more of the consolidated assets of the company. This language does not require that only the ultimate parent be considered and thus any subsidiary that is 85% financial would be by definition a nonbank financial company and could be considered for designation under section 113. **Senate Bill § 102(a)(4) and (6), as amended by S.A. 4003 sponsored by Senator Vitter (pp. 20-21).**

The Vitter-Pryor amendment also provides a new "anti-evasion" provision, under which the Council may subject identified risky activities of a nonbanking company to Fed supervision. It must do so either on its own initiative or at the request of the Fed, and by a vote of 2/3 of its members (including the Chairperson) must determine that (1) material financial distress related to financial activities conducted directly or indirectly by a U.S. company or the financial activities in the United States of a non-U.S. company would pose a threat to the financial stability of the United States based on a consideration of the factors under Section 113(a) (see below); (2) the company is "organized or operates in such a manner as to evade" the application of Title I (i.e. the company is not at least 85% financial); and (3) such financial activities of the company will be supervised by the FRB and subject to heightened prudential standards. **Senate Bill § 113(c), as amended by S.A. 4003 sponsored by Senators Vitter & Pryor (pp. 37-40).**

If such a determination is made, then the identified "financial activities" of that company will be subject to Fed supervision and stricter prudential standards. For the purposes of this section, "financial activities" are defined as those that are financial in nature under Section 4(k) of the BHC Act and those related to the ownership or control of one or more insured depository institutions, but do not include "internal financial activities" conducted for the company or its affiliates. The Amendment states that the Fed may require such a company to establish an intermediate holding company, as provided for under Senate Bill Section 167, in which to conduct these financial activities, in which case the intermediate holding company would be subject to Fed supervision and stricter prudential standards. Nonfinancial activities could not be supervised or regulated by the Fed under this provision. **Senate Bill § 113(c), as amended by S.A. 4003 sponsored by Senator Vitter (pp. 37-40).**

House Bill

The House Bill differs from the Senate Bill in the scope of potential companies that could be subject to stricter prudential standards. Under H.R. 4173, the Council would be authorized to subject any "financial company" to stricter prudential standards if the Council determines that either (1) material financial distress at the company could pose a threat to financial stability or the economy; or (2) the nature, scope, size, scale, concentration, and interconnectedness, or mix

of the company's activities could pose a threat to financial stability or the economy. A "financial company" would be defined as a company or other entity that is:

(1) incorporated or organized under the laws of the United States or any state, territory, or possession of the United States, or a company incorporated in or organized in a country outside the United States that has significant operations in the United States through a federal or state branch of agency of a foreign bank (terms defined in International Banking Act of 1978) or a United States affiliate or other operating entity;

(2) that is, in whole or in part, directly or indirectly, engaged in financial activities;[4] and

(3) is not a Farm Credit System institution chartered under and subject to the provisions of the Farm Credit Act of 1971. **Section 1000(b)(4) (pp. 16-17).**

Thus, unlike the Senate Bill, under the House Bill bank holding companies with consolidated assets over $50 billion would not automatically be subject to stricter prudential standards. However, the Council would have the authority to subject bank holding companies with assets under $50 billion to stricter standards, while the Senate Bill specifically provides that such standards shall not apply to bank holding companies with assets under $50 billion. The Vitter-Pryor Amendment is intended to ensure that systemically significant financial companies that are not bank holding companies can be regulated under the new regime in the bill only if they are "predominantly" (85%) financial, while providing a means to address specific risky activities in an entity less than 85% financial—but not to regulate or supervise nonfinancial companies or activities.

2. Standards for subjecting a company to Fed supervision and stricter prudential standards

Each determination made with respect to a nonbank financial company or a "evasive" company would need to be based on the Council's consideration of:

- the degree of leverage of the company;
- the amount and nature of the company's financial assets;
- the amount and types of the company's liabilities (including degree of reliance on short-term funding);
- the extent and type of off-balance-sheet exposures;

[4] Title I does not define "financial activities."

- the extent and type of the transactions and relationship the company has with other significant nonbank financial companies and significant bank holding companies;

- the importance of the company as a source of credit for households, businesses, and State and local governments, as well as a source of liquidity for the United States financial system;

- the recommendation, if any, of a member of the Council;

- the operation of, or ownership interest in, any clearing, settlement, or payment business;

- the extent to which assets are managed rather than owned and to the extent which ownership of assets under management is diffuse;

- and any other factors the Council deems appropriate. **Senate Bill §§ 113(a)(2)(A)-(I) (pp. 35-37); H.R. 4173 § 1103(b) (pp. 46-49).**

The same types of factors are also considered under the House Bill. **H.R. 4173 § 1103(b) (pp. 46-49).**

3. Information Gathering by the Council

Senate Bill

The Council and the Fed would be authorized to receive, and could request the production of, any data or information from the Office of Financial Research and member agencies necessary to fulfill the Council's specified duties or to otherwise carry out any of the provisions of Title I. **Senate Bill § 112(b)(2) (p. 31); H.R. 4713 § 1101(a) (p. 40).**

Acting through the Office, the Council could require nonbank financial companies and bank holding companies to submit periodic reports for the purpose of assessing the extent to which the company or its financial activities pose a threat to financial stability. **Senate Bill § 112(b)(3)(A) (p. 31).** Before requiring such a report, the Council would be required, whenever possible, to rely on information already available from the Office or from other financial regulatory agencies. **Senate Bill §§ 112(b)(3)(B) (pp. 31-32); H.R. 4173 § 1101(c) (pp. 41-42).** If the Council cannot determine whether a company poses a threat based on the documents provided, the Council may request that the Fed conduct an examination for the sole purpose of determining whether the nonbank financial company should be supervised. **Senate Bill § 112(b)(4) (p. 32).**

The Senate Bill would require the Council, the Office, and other agencies to maintain the confidentiality of any data, information, and reports submitted under § 112(b)(3)(A). **Senate Bill § 112(b)(5)(A) (p. 32).** It is also important to note that a company or entity would not waive its applicable privileges by sharing its information with the Council, any Federal or State financial regulator, or any other agency of the Federal government under this Title. **Senate Bill § 112(b)(5)(B) (pp. 32-33); H.R. 4173 § 1101(e)(2) (pp. 43).** Also, note that the Freedom of

Information Act and its exceptions would apply to this provision. **Senate Bill § 112(b)(5)(C) (p. 33).**

House Bill

Under the House Bill, the Council and the Board are authorized to receive, and can request the production of, any data or information from Council members that is necessary to fulfill the Council's specified duties or otherwise carry out any of the provisions of Title I of H.R. 4173. The Council may require the submission of reports from financial companies for the purpose of assessing the extent to which the company itself or its financial activities pose a threat to financial stability. **H.R. 4173 § 1101(a) (p. 40)** H.R. 4173, however, dictates that before requiring such a report, the Council should rely on information already being collected by other financial regulatory agencies whenever possible. **H.R. 4173 § 1101(c) (pp. 41-42)** Additionally, there are provisions in H.R. 4173 that cover data and information sharing and encourage such coordination among agencies. **H.R. 4173 § 1101(d)-(e) (p. 42-43)** Also important to note is that a company or entity does not waive its applicable privileges by sharing its information with the Council, any federal financial regulator or State financial regulator, or any other agency of the federal government under this title. **H.R. 4173 § 1101(e)(2) (pp. 43)**.

4. Notification of Decision, Periodic Review, and Appeal Mechanism

Senate Bill

The Council would be required to provide a nonbank financial company with written notice of a proposed determination, which would subject the financial company to the Fed's supervision and stricter prudential standards. Such notice would include a basis for this proposed determination. **Senate Bill § 113(e)(1) (p. 41); H.R. 4173 § 1103(c) (p. 49).**

The nonbank financial institution would have 30 days upon receipt of such notice to request, in writing, an opportunity for a written or oral hearing before the Council to contest the proposed determination. Within 30 days of this written request, the Council would have an additional 30 days to set a time and location at which the company could appear personally, or through counsel, to submit written materials. The Council would also have the independent authority to insist on oral testimony or arguments. **Senate Bill § 113(e)(2) (p. 41).** Within 60 days of the hearing, the Council would be required to notify the nonbank financial company of its decision as well as its basis for this decision. **Senate Bill § 113(e)(3) (p. 42).**

In the event that the nonbank financial company does not request a hearing within 30 days of receiving the proposed determination, the Council would have 10 days from the date by which the nonbank financial company was required to respond to notify the nonbank financial company of its final determination. **Senate Bill § 113(e)(4) (p. 42).**

There is, however, an emergency exception to both the obligation of the company to respond within 30 days and the obligation of the Council to issue a final decision within 10 days of the past deadline. The Council could waive either requirement by a 2/3 vote of the members where the waiver is either necessary or appropriate to prevent or mitigate risks posed by the company to the financial stability of the United States. **Senate Bill § 113(f)(1) (p. 42).** When

such a waiver is granted, the Council would be required to provide notice to the company within 24 hours. **Senate Bill § 113(f)(2) (p. 43).** A nonbank financial company would have 10 days after receipt of this additional notice to request, in writing, a written or oral hearing to contest the waiver or modification. The Council would then have 15 additional days to fix a time and place for the written or oral hearing. The Council would also have the independent authority to insist on either written or oral testimony. **Senate Bill § 113(f)(3) (p. 43).** After the hearing, the Council would have 30 days to notify the company of its final determination as well as the basis for this determination. **Senate Bill § 113(f)(4) (p. 33).**

Prior to making any final determinations under this subsection, the Council would be required to consult with the primary financial regulatory agency, if any, for each nonbank financial company or subsidiary being considered for supervision. **Senate Bill § 113(g) (p. 44).** Final determinations would also be subject to judicial review. Nonbank financial companies would have 30 days upon receipt of a final determination to bring an action in a United States district court for an order of rescission. The standard for this review would be limited to "arbitrary and capricious" action by the Council. **Senate Bill § 113(h) (p. 44); H.R. 4173 § 1103(e) (p. 50).**

House Bill

Under the House Bill, the financial company would be notified that it is subject to stricter prudential standards in a public order by the Board, acting in an executive capacity on behalf of the Council. **H.R. 4173 § 1103(c) (p. 49)** Under H.R. 4173, the Council would need to establish an appeal procedure by which a company that has been subjected to stricter prudential standards can challenge this decision. Further, any financial company subject to stricter prudential standards can seek judicial review by filing a petition in the D.C. Circuit. **H.R. 4173 § 1103(e) (p. 50)**.

5. End of Designation of Heightened Prudential Scrutiny

Senate Bill

Under the Senate Bill, the Council would be required to reevaluate each decision to subject a nonbank financial company to stricter prudential standards annually. Any rescission of these standards would require a 2/3 vote by the Council, including an affirmative vote by the Chairperson. **Senate Bill § 113(d)(1)-(2) (pp. 40-41); H.R. 4173 § 1108 (p. 116).**

House Bill

When the Council determines that a company or activity or practice is no longer subject to heightened prudential scrutiny, the Board must then inform the relevant primary financial regulatory agency or agencies of that finding. A primary financial regulator that has imposed stricter prudential standards under Title I shall then determine whether these standards should remain in effect. **H.R. 4173 § 1108 (p. 116).**

6. Registration with the Fed

Section 114 of the Senate Bill would require a nonbank financial company to register with the Fed within 180 days if the Council makes a final determination that the company is to be supervised by the Fed. **Senate Bill § 114 (p. 45).**

7. Council Recommendations Concerning Stricter Prudential Standards for Large Interconnected Bank Holding Companies and Nonbank Financial Companies

Senate Bill

The Senate Bill provides that the Council may make recommendations to the Fed regarding the establishment of stricter prudential standards and any reporting or disclosure requirements applicable to large interconnected bank holding companies with total consolidated assets greater than $50 billion and nonbank financial companies supervised by the Fed. **Senate Bill § 115(a)(1) (pp. 45-46).** Section 165(b), described in further detail below, addresses the Fed's authority to implement such enhanced supervision on its own, or following Council recommendations.

The Council's recommendations would not apply to bank holding companies with total consolidated assets of less than $50 billion, and the Council would have the authority to raise the threshold amount above $50 billion for any particular standard. **Senate Bill § 115(a)(2) (p. 46).**

Recommendation of the Council could include those relating to:

- risk-based capital requirements;
- leverage limits;
- liquidity requirements;
- resolution plan and credit exposure report requirements;
- concentration limits;
- a contingent capital requirement;
- enhanced public disclosures; and
- overall risk management requirements.

Senate Bill § 115(b)(1) (pp. 46-47).

House Bill

The House Bill, similar to the Senate Bill, authorizes the Council to issue formal recommendations that a federal financial regulatory agency adopt heightened prudential

standards for firms it regulates in order to mitigate systemic risk. In response to such a recommendation, a federal agency may impose, require reports regarding, examine for compliance with, and enforce the stricter prudential standards for the firms it regulates. In applying these heightened prudential standards to any foreign financial parent or the parent's related branch, subsidiary, or other operating entity, the federal financial regulatory agency is required to take into account the principles of national treatment and equality of competitive opportunity, as well as consider the extent to which the foreign financial parent is subject to comparable standards in the home country. The federal agency must notify the Council regarding the actions it has taken in response to the Council's recommendation or the reason why it has failed to respond to the Council's request. **H.R. 4173 § 1102 (pp. 44-46)**.

8. Application of the Required Standards

a) Differentiation Permitted

In making recommendations, the Senate Bill would allow the Council to take into account differences among nonbank financial companies supervised by the Fed and covered bank holding companies based on:

- the factors described above in Section 113(a) and (b);
- whether the company owns an insured depository institution;
- nonfinancial activities and affiliations of the company; and
- any other factors the Council deems appropriate.

Further, to the extent possible, the Council would be required to insure that small changes in these factors (Sections 113(a) and (b)) would not result in sharp, discontinuous changes in prudential standards applied. **Senate Bill §§ 115(b)(3)(A)-(B) (pp. 47-48); H.R. 4173 § 1104(a)(3) (pp. 61-62).**

b) Application to Foreign Financial Companies

In making recommendations that would apply to foreign nonbank financial companies supervised by the Fed or foreign-based bank holding companies, the Senate Bill directs the Council to give due regard to principles of national treatment and competitive equity. **Senate Bill § 115(b)(2) (p. 47).** Section 165 also directs the Fed to give the same due regard to principles of national treatment and competitive equity in applying these standards. **Senate Bill § 165(b)(2) (p. 95); H.R. 4173 § 1104(a)(5) (p. 62).**

9. Contingent Capital Study by the Council

Senate Bill

Under Section 115, the Council would be required to conduct a study of the feasibility, benefits, costs, and structure of imposing any contingent capital requirement, and to submit a report to Congress within two years of the date of enactment of the Act. **Senate Bill**

§§ 115(c)(1)-(3) (pp. 48-50); H.R. 4173 § 1116(c) (pp. 134). This report would include an evaluation of the degree to which a contingent capital requirement would enhance the safety and soundness of a company subject to the requirement, as well as promote the financial stability of the United States and reduce risks to United States taxpayers. **Senate Bill § 115(c)(1)(A) (p. 48).** The Council would also be required to evaluate:

- the characteristics and amount of convertible debt;
- potential prudential standards that should be used to determine whether the contingent capital of the company would be converted to equity during times of financial stress;
- the costs to companies, the effects on the structure and operation of credit and other financial markets, and other economic effects of requiring contingent capital;
- the effects of requirements on the international competitiveness of companies subject to the requirements; and
- prospects of international coordination of such requirements.

In addition to its evaluations, the Council would be required to submit recommendations for implementing its proposed regulations. **Senate Bill §§ 115(c)(1)(B)-(F) (pp. 48-49).**

The provision would also authorize the Council to make recommendations to the Fed to require a nonbank financial company subject to Fed supervision to maintain a minimum amount of long-term hybrid debt, capable of being converted to equity in times of financial stress. **Senate Bill § 115(c)(3)(A) (pp. 49-50).** Section 165(c) would grant the Fed authority to promulgate appropriate regulations to enforce such requirements. **Senate Bill § 165(c)(1) (pp. 96-97).** Factors that the Council would be required to consider in making these recommendations include:

- the appropriate transition period for implementation of a conversion under this subsection;
- the factors described in Section 115(b)(3) (discussed above);
- capital requirements applicable to a nonbank financial company supervised by the Fed or a large bank holding company and its subsidiaries;
- the results of the study undertaken by the Council; and
- any other factors that the Council deems appropriate.

Senate Bill §§ 115(c)(3)(B)(i)-(v) (p. 50) and 165(c)(2)(A)-(E) (pp. 97-98).

House Bill

A study would also be required under the House Bill to determine the optimal implementation of contingent capital requirements to maximize financial stability, minimize the

probability of drawing on the Systemic Resolution Fund, and minimize costs for financial holding companies subject to stricter standards. **H.R. 4173 § 1116(c) (pp. 134).**

10. Resolution Plan and Credit Exposure Reports

Senate Bill

The Senate Bill would allow the Council to make recommendations to the Fed concerning the requirement that each nonbank financial company and bank holding company supervised by the Fed periodically report its plans for rapid and orderly resolution in the event of a material financial distress or failure to the Council, the Fed, and the FDIC. **Senate Bill § 115(d)(1) (pp. 50-51).** The Senate Bill would also allow the Council to recommend that such companies report on the nature and extent to which they have credit exposure to other significant nonbank financial companies and bank holding companies, as well as the nature and extent to which other significant nonbank financial companies and bank holding companies have credit exposure to them. **Senate Bill § 115(d)(2)(A)-(B) (p. 51); H.R. 4173 §§ 1104(f)(1) and (2) (pp. 96-97).**

House Bill

Under the House Bill, the Board would require each financial holding company subject to stricter standards ("FHCSSS") to periodically report to the Board on three matters: (1) its plan for rapid and orderly resolution in the event of severe financial distress; (2) the nature and extent to which the company has credit exposure to other significant financial companies; and (3) the nature and extent to which other significant financial companies have credit exposure to it. Such plans shall not be binding on a receiver or a bankruptcy court. **H.R. 4173 § 1104(f)(1) and (2) (pp. 96-97)**.

Under the House proposal, a resolution plan would need to demonstrate that any insured depository institution affiliated with a FHCSSS is adequately insulated from the activities of any non-bank subsidiary of the institution. The plan would also need to include information detailing the nature and extent to which the company has credit exposure to other significant financial companies and vice versa; a full description of the company's ownership structure, assets, liabilities, and contractual obligations; information regarding cross-guarantees tied to different securities, a list of major counterparties, and a process for determining where the company's collateral is pledged. **H.R. 4173 § 1104(i) (p. 99-101).**

Each time the results of a stress test under baseline or adverse indicate that a FHCSSS is significantly or critically undercapitalized, that company must submit a rapid resolution plan that has been revised to address the causes of those results. Financial companies that are not subject to stricter standards but are deemed to be significantly or critically undercapitalized, as a result of their semiannual stress tests, must also submit rapid resolution plans. **H.R. 4173 § 1104(f)(3) (p. 97).**

Upon the submission of a rapid resolution plan, the Corporation and the Board, after consulting any federal financial regulatory agencies with jurisdiction over the FHCSSS, would be required to jointly review the plan and could require the FHCSSS to revise the plan. The Corporation, after consultation with the Board, would have the authority to take any enforcement

action in FDI Act § 8 against a FHCSSS that fails to submit a rapid resolution plan or otherwise comply with the requirements of this section. **H.R. 4173 § 1104(i)(3-4) (pp. 101-102)**.

Note that H.R. 4173 would, as a practical matter, give the Board authority sufficient to cause a FHCSSS submitting a plan to restructure. The enforcement authority granted under FDI Act § 8 is very broad and includes not only the power to terminate federal deposit insurance, enter cease and desist orders and remove management but also the authority to place limits on the activities or functions of an insured institution or any of its affiliates. **FDI Act § 8(b)(7).**

11. Concentration Requirements

Section 115(e) would authorize the Council to make recommendations to the Fed to prescribe stricter standards to limit risks posed by the failure of any individual company to bank holding companies and nonbank financial companies under the supervision of the Fed. **Senate Bill §§ 115(e)(1) (pp. 51-52).** Section 165(e)(1) would direct the Fed to prescribe standards that limit such risks. **Senate Bill § 165(e)(1) (p. 101).**

Specifically, the regulations prescribed by the Fed would prohibit each bank holding company and nonbank financial company supervised by the Fed from having credit exposure[5] to any unaffiliated company in excess of 25 percent of the capital stock and surplus of that company. The Fed would also have authority to set by regulation a lower amount if needed to mitigate risks to United States financial stability. **Senate Bill § 165(e)(2) (p. 102).**

The Fed would be authorized to exempt transactions, in whole or in part, if it determines that the exemption is in the public interest or consistent with the purpose of this subsection. This provision also contains a three year transition period. **Senate Bill § 165(e)(7)(A) (p. 104).** The Fed would also have the option of extending the transition period for an additional two years. **Senate Bill § 165(e)(7)(B) (p. 104); H.R. 4173 § 1104(c) (pp. 66-69).**

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[5] For purposes of this subsection, the Senate Bill defines "credit exposure" to a company to mean: (1) all extensions of credit to the company, including loans, deposits, and lines of credit; (2) all repurchase agreements and reverse repurchase agreements with the company; (3) all securities borrowing and lending transactions with the company, to the extent that such transactions create credit exposure for the nonbank financial company supervised by the Board or bank holding company; (4) all guarantees, acceptances, or letters of credit issued on behalf of the company; (5) all purchases of or investment in securities issued by the company; (6) counterparty credit exposure to the company in connection with a derivative transaction between the financial holding company subject to stricter standards and the company; and (7) any other similar transaction that the Board by regulation determines to be credit exposure for the purposes of this subsection. **Senate Bill § 165(e)(3) (pp. 102-103).**

12. Enhanced Public Disclosures

The Council could recommend that the Fed require periodic public disclosures by large, interconnected bank holding companies and by nonbank financial companies supervised by the Fed in order to support market evaluation of the risk profile, capital adequacy and risk management capabilities of such companies. **Senate Bill § 115(f) (p. 52).**

13. Reports to the Council

The Council, acting through the Office, could require a bank holding company with total consolidated assets of $50 billion or greater, or a nonbank financial company supervised by the Fed and any subsidiary thereof, to submit certified reports to keep the Council informed as to:

- the financial condition of the company;
- systems for monitoring and controlling financial, operating, and other risks'
- transactions with any subsidiary that is a depository institution; and
- the extent to which the activities and operations of the company and any subsidiary thereof could, under adverse circumstances, have the potential to disrupt financial markets or affect the overall financial stability of the United States.

That said, the Council would also be required, to the extent possible, to use existing reports and other publicly available information before requiring such reports. **Senate Bill § 116 (pp. 52-54).**

14. Continued Regulation of Certain Former Bank Holding Companies

Under Section 117, bank holding companies that had $50 billion or more in consolidated assets as of January 1, 2010 that also received financial assistance under the Capital Purchase Program under TARP will be treated as a nonbank financial company supervised by the Fed automatically, without the Council needing to make its determination under Section 113. **Senate Bill § 117 (p. 54)**. Such a company can appeal this designation before the Council and a timeline for this process is set forth in the provision. In making its decision on such an appeal, the Council is to consider whether the company meets the standards for being a supervised nonbank financial company under Section 113. The Council's determination is final – there is no provision for a judicial appeal. **Senate Bill § 117 (pp. 55-56)**. As a practical matter, this means that a company meeting these conditions would be able to avoid application of the Bank Holding Company Act, and the activities restrictions of Section 4 of the BHC Act, but would continue to be subject to enhanced prudential standards and portions of the Volcker provisions applicable to supervised nonbank financial companies, including heightened capital requirements and limits on investing in hedge and private equity funds and engaging in proprietary trading. **See, Senate Bill § 619 (beginning on p. 476)**.

15. Subjecting Activities or Practices to Stricter Prudential Standards for Financial Stability Purposes

The Council could issue recommendations to a company's primary financial regulatory agency to apply new or heightened prudential standards and safeguards for a financial activity or practice conducted by bank holding companies or nonbank financial companies under the agency's jurisdiction. The Council would be authorized to issue recommendations where it determines that the conduct of the activity or practice could create or increase the risk of significant liquidity, credit, or other problems spreading among other companies or United States financial markets. **Senate Bill § 120(a) (pp. 58-59).**

a) Consultation Requirement

Prior to issuing recommendations, the Council would be required to consult with the appropriate primary financial regulatory agency, provide notice and opportunity for comment on any proposed recommendations, and consider the effect of any recommendation on costs to long-term economic growth. **Senate Bill §§ 120(b)(1) (p. 59).** The Council would also be authorized to recommend specific actions to apply to the conduct of a financial activity or practice, including limits on scope or additional capital and risk management requirements. **Senate Bill § 120(b)(2)(B) (p. 59); H.R. 4173 § 1107(a) (pp. 113-114).**

The primarily financial regulatory agency would be required to impose the standards recommended by the Council – or similar standards that the Council deems appropriate – within 90 days after the date of recommendation. Alternatively, the regulatory agency would have 90 days to explain in writing why the recommendation is not being implemented. **Senate Bill § 120(c)(2) (pp. 60-61).** All recommendations and subsequent actions or inactions by the agency would need to be reported by the Council to Congress. **Senate Bill § 120(d) (p. 61).**

b) Effect of Rescission of Identification

Section 120(e)(1) would grant the Council the authority to determine that an activity or practice is no longer subject to heightened prudential scrutiny. **Senate Bill § 120(e)(1) (p. 61).** The Council would need to inform the primarily financial regulatory agency imposing such heightened standards or safeguards of its decision to rescind its determination. Reflectively, § 120(e)(2) would grant the agency the authority to determine whether to keep the standards in effect. **Senate Bill § 120(e)(2) (pp. 61-62); H.R. 4173 § 1108 (p. 116).**

D. Fed Authority to Implement Enhanced Supervision of Designated Nonbank Financial Companies and Bank Holding Companies Over $50 Billion

1. Prudential Standards Imposed by the Fed

In order to prevent or mitigate risks to financial stability, the Senate Bill would require the Fed to establish prudential standards and disclosure requirements applicable to nonbank financial companies and large, interconnected bank holding companies supervised by the Fed. The Fed could establish such standards either on its own initiative or pursuant to the Council's recommendations. These standards would be more stringent than the standards applicable to

nonbank financial companies and bank holding companies that do not present similar risks to financial stability. The Fed may not apply such standards to any bank holding company with total consolidated assets of less than $50 billion, and the Fed could establish a higher asset threshold for the applicability of any particular standard. **Senate Bill § 165(a) (pp. 93-94).**

2. Required and Suggested Standards

Under Section 165, the Fed would be required to establish prudential standards that include:

- risk-based capital requirements;
- leverage limits;
- liquidity requirements;
- resolution plan and credit exposure report requirements; and
- concentration limits.

Additional standards could include a contingent capital requirement, enhanced public disclosures, and overall risk management requirements. **Senate Bill § 165(b)(1) (pp. 94-95).**

In prescribing such prudential standards, the Fed would be required to take into account differences among the nonbank financial companies supervised by the Fed and the large, interconnected bank holding companies, based on the criteria considered by the Council in making its decision to subject a nonbank company to Fed supervision (such as the company's leverage, amount and nature of financial assets, and liabilities), whether the company owns an insured depository institution, and whether the company engages in nonfinancial activities or affiliations. The Fed would be required to submit an annual report to Congress regarding the implementation of such standards and the use of these standards to mitigate risks to the financial stability of the United States. **Senate Bill §§ 165(b)(3) and (4) (pp. 95-96).**

3. Contingent Capital

After reporting to Congress as required by Section 115, the Fed would be authorized to promulgate regulations that require each nonbank financial company and large bank holding company supervised by the Fed to maintain a minimum amount of long-term debt that is convertible to equity in times of financial stress. In devising such a requirement, the Fed would need to consider the results of the Council's study under Section 113, an appropriate transition period, and the capital requirements applicable to the company, as well as other factors that the Fed deems appropriate. **Senate Bill § 165(c) (pp. 96-98).**

4. Concentration Limits

The Fed would be required to prescribe regulations that prohibit each nonbank financial company supervised by the Fed and each large, interconnected bank holding company from having credit exposure to any unaffiliated company that exceeds 25 percent of the capital stock

and surplus of the company (or a lower amount if the Fed determines necessary to mitigate risks to financial stability). **Senate Bill § 165(e)(2) (p. 102).** The term "credit exposure" is defined broadly in the Senate Bill. **Senate Bill § 165(e)(3) (pp. 102-103).**

The subsection governing these concentration limits, as well as any related regulations and orders by the Fed, would not be effective until three years after the Act is enacted. **Senate Bill § 165(e)(7) (p. 104).**

5. Leverage and Risk-Based Capital Requirements

Under an amendment proposed by Senator Collins (R-ME) and adopted during floor debate, SA 3879, the Senate Bill would impose minimum leverage and risk-based capital requirements on banks, bank holding companies and Fed supervised nonbank financial companies. In the final print of the Senate Bill this amendment has been designated as Section 171. **Senate Bill § 171 (pp. 113- 117)**.

Section 171 would prevent regulators from weakening capital standards below the "generally applicable" standards as in effect as of the date the law is passed and therefore would reduce future Federal bank regulator discretion. "Generally applicable" leverage capital requirements are defined as the minimum ratios of tier 1 capital to average total assets, as established by the appropriate Federal banking agencies to apply to insured depository institutions under the agency's prompt corrective action regulations that implement section 38 of the FDI Act. Some commentators have noted that the amendment could be read to prevent companies from counting trust preferred securities (TPS) towards tier 1 capital, as TPS are excluded as a tier 1 capital component for banks under the prompt correction rules.

Section 171 also requires that capital requirements be applied consistently regardless of an institution's total consolidated asset size or foreign financial exposure. This could be read to eliminate the small-bank holding company (less than $500 million in assets) exemption for consolidated capital requirements. **Senate Bill § 171, as amended by S.A. 3879 (pp. 113-117).** Further, federal banking agencies (subject to Council recommendation) would be required develop capital requirements applicable to bank holding companies with assets of $50 billion and nonbank financial companies subject to Fed supervision that address the risks the activities of the institutions pose to themselves and "other public and private stakeholders". Risk considerations are to include dealings in derivatives, securitized products, financial guarantees, securities borrowing or lending, repo and reverse repo agreements, concentrations of illiquid assets, and concentrations in market activities that would disrupt financial markets if the institution ceased the activity. **Senate Bill § 171, as amended by S.A. 3879 (pp. 113-117).**

6. Enhanced Public Disclosures

In order to support market evaluation of the risk profile, capital adequacy, and risk management capabilities of a company, the Fed could prescribe, by regulation, periodic public disclosures by nonbank financial companies supervised by the Fed and large, interconnected bank holding companies. **Senate Bill § 165(f) (p. 104).**

7. Risk Committees

Each publicly traded nonbank financial company supervised by the Fed would be required to establish a risk committee within one year of being subject to the Fed's supervision. Further, each bank holding company that is publicly traded and has assets of at least $10 billion would be required establish a risk committee. The Fed would have discretion as to whether to require publicly traded bank holding companies with assets of less than $10 billion to establish such a committee. The risk committee would be responsible for the oversight of the enterprise-wide risk management practices of the given company. It must include independent directors (the exact number to be determined by the Fed) and at least one risk management expert. **Senate Bill § 165(g) (pp. 105-106).**

8. Stress Tests

Under § 165(h) of the Senate Bill, the Fed would be required to evaluate whether nonbank financial companies and large bank holding companies subject to its supervision have the capital (on a total consolidated basis) necessary to absorb losses as a result of adverse economic conditions. The Fed would be free to develop and apply analytical techniques for identifying, measuring, and monitoring risks to the financial stability of the United States, however it sees fit. **Senate Bill § 165(h) (p. 107).** Note that under H.R. 4173, financial holding companies subject to stricter standards would themselves be required to conduct quarterly stress tests. **H.R. 4173 § 1115.**

9. Reports by and Examinations of Nonbank Financial Companies by the Fed

Section 161 would grant the Fed authority to require reports from any nonbank financial company subject to its supervision and its subsidiaries concerning the nature of the operations and financial condition of the company and its subsidiaries. The Fed would also have the authority to require reports regarding compliance by the company or subsidiary with the requirements of Title I, as well as any other risks within the company that may pose a threat to the safety and soundness of the company or the stability of the United States financial system. Further, the Fed would be authorized to examine any nonbank financial company it supervises, or its subsidiary, to determine the nature of the operations and financial condition of the company, the risks the company poses to the financial stability of the United States, the systems for monitoring and controlling such risks, and the company's compliance with Title I. **Senate Bill §§ 161(a)(1) and (b)(1) (pp. 86-88).**

To the fullest extent possible, the Fed would be required to rely on reports or supervisory information already provided by a nonbank financial company or its subsidiary to Federal and State regulatory agencies. **Senate Bill § 161(a)(2)(A) (pp. 86-87).** The Fed would also be required, to the extent possible, to rely on externally audited financial statements, information otherwise obtainable from regulatory agencies, or information publicly reported. **Senate Bill § 161(a)(2)(B)-(D) (p. 87).** A nonbank financial company supervised by the Fed would be required to provide this information upon request. **Senate Bill § 161(a)(3) (p. 87).** The Senate Bill also would also require that the Fed provide the primary financial regulatory agency reasonable notice before requiring a report, requesting information, or commencing an

examination of a subsidiary under this subsection. **Senate Bill § 161(c)(1) (p. 88).** The Fed is further directed to avoid duplicate examination activities and requests for information. **Senate Bill § 161(c)(2) (p. 89).**

10. Enforcement

a) Enforcement Authority Under the FDI Act

A nonbank financial company supervised by the Fed and any of its subsidiaries (other than depository institutions) would be subject to the provisions of subsections (b) through (n) of Section 8 of the Federal Deposit Insurance Act (12 U.S.C. § 1818) (the "FDI Act") in the same manner and to the same extent as if the company were a bank holding company. **Senate Bill § 162(a) (p. 89).** Under these provisions of the FDI Act, the appropriate Federal banking agency would have broad power to take enforcement actions against the company if it has reason to believe that the company has engaged, or is about to engage, in an unsafe or unsound practice in conducting its business. Such enforcement action may include the issuance of a cease and desist order or an order requiring affirmative action to correct conditions resulting from violations or unsafe practices.

b) Enforcement Authority for Functionally Regulated Subsidiaries

Under § 162(b) of the Senate Bill, the Fed would be able to determine that a condition, practice, or activity of a depository institution subsidiary or functionally regulated subsidiary of a nonbank financial company under Fed supervision does not comply with the Fed's regulations or otherwise poses a threat to financial stability. In the event this determination is made, § 162(b) further authorizes the Fed to issue written recommendations to the subsidiary's primary financial regulatory agency that direct the agency to initiate supervisory action or enforcement proceedings. The Fed would also need to provide a written explanation of its relevant concerns. **Senate Bill § 162(b)(1) (pp. 89-90).**

If a financial regulatory agency does not initiate an action or enforcement proceeding within 30 days of receiving the Fed's recommendation, the Fed would also be authorized to report this failure to take action to the Council. **Senate Bill § 162(b)(2) (p. 90).**

11. Resolution Plans ("Living Wills")

Each nonbank financial company supervised by the Fed and large, interconnected bank holding company would be required to submit a plan for rapid and orderly resolution in the event of material financial distress or failure. Further, such a company is required to report periodically to the Council, the Fed, and the FDIC on the nature and extent to which the company has credit exposure to other significant nonbank financial companies and significant bank holding companies and the degree to which such companies have credit exposure to it. The Fed would then review the resolution plan, notify the company of any deficiencies, and require the company to resubmit a plan if such deficiencies are identified.

If a company fails to timely submit a resolution plan or comply with required revisions, the Fed and FDIC may impose more stringent capital, leverage, or liquidity requirements or

restrictions on the growth, activities, or operations of the company or its subsidiaries until the company submits a plan and remedies all deficiencies. If the Fed has imposed more stringent requirements on the company and the company has still failed, within a two year period, to resubmit the resolution plan with required revisions, the Fed and the FDIC (in consultation with the Council) could then direct the company to divest assets or operations to facilitate an orderly resolution of the company under Title 11 of the United States Code. **Senate Bill § 165(d) (pp. 98-101).**

12. Mitigatory Action

Senate Bill § 121 would authorize the Fed to take action beyond the imposition of stricter prudential standards if it determines that such standards are inadequate to mitigate a threat to the financial stability of the United States. Under § 121(a) the Fed could, by a 2/3 vote, take additional mitigatory actions against a bank holding company with total consolidated assets of at least $50 billion or against a nonbank financial company it supervises if the Fed determines that the company poses a grave threat to the financial stability of the United States. **Senate Bill § 121(a) (pp. 62-63).** Such mitigatory actions could include:

- terminating one or more activities;
- imposing conditions on the manner in which the company conducts one or more activities; or
- in the event the Council deems the other measures inadequate to address the identified risks, selling or otherwise transferring off-balance-sheet items to unaffiliated entities. **Senate Bill § 121(a)(1)-(3) (pp. 62-63).**

This section also would authorize the Fed to prescribe regulations relating to foreign nonbank financial companies and foreign-based bank holding companies, giving due regard to principles of national treatment and competitive equity are required. **Senate Bill § 121(d) (p. 64).**

In making the decision to require one or more mitigatory actions, the Fed would be required to consider the same criteria as those used to impose stricter prudential standards. These factors are set forth in subsection (a) or (b) of Section 113 (discussed above). **Senate Bill § 121(c) (p. 64).**

The Fed, in consultation with the Council, would also be required to provide written notice and an opportunity for hearing to the company being considered for mitigatory action. **Senate Bill § 121(b)(1) (p. 63).** Written notice must include an explanation for the Fed's consideration of such action. **Senate Bill § 121(b)(1) (p. 63).** The company would then have 30 days upon receipt of notice to submit a written request for a hearing to the Fed. The Fed would also have 30 days from receipt of a company's timely request to schedule a time and place for the company to appear and submit written materials. The Fed, in consultation with the Council, would also have the authority to insisting on oral testimony or argument. **Senate Bill § 121(b)(2) (pp. 63-64).**

Under § 121, the Fed would be required to notify the company of its decision within 60 days of a hearing, or – in the case where no hearing is requested – within 60 days of its first written notice. **Senate Bill § 121(b)(3) (p. 64).**

House Bill

Under the House Bill, the Council would also be able to take action beyond the imposition of stricter prudential standards if the Council determines (after notice and an opportunity for hearing) that despite the higher prudential standards imposed on a financial holding company, the size, scope, nature, scale, concentration, interconnectedness, or mix of activities directly or indirectly conducted by that company poses a grave threat to the financial stability or economy of the U.S.. **H.R. 4173 § 1105(a) (p. 104)**

If the Council were to make such a determination, then it could require the company to undertake one or more mitigatory actions aimed at reducing this threat. Such mitigatory actions could include:

i. Modifying the stricter prudential standards imposed;

ii. Terminating one or more activities;

iii. Imposing conditions on the manner in which the company conducts one or more activities;

iv. Limiting the ability to merge with, acquire, consolidate with, or otherwise become affiliated with another company;

v. Restricting the ability to offer a financial product or products; and

vi. In the event the Council deems the other measures inadequate to address the identified risks, selling, divesting, or otherwise transferring business units, branches, assets, or off-balance sheet items to unaffiliated companies—but only in the event that the above actions are inadequate. **H.R. 4173 § 1105(d)(1) (p. 106)**

In determining whether to impose any requirement that is likely to have a significant impact on a functionally regulated subsidiary or a subsidiary depository institution of a FHCSSS, the Council would be required to consult with the federal financial regulatory agency for any such subsidiary. With respect to requirements likely to have a significant effect on an insurance company, the Council would need to consult the Federal Insurance Office. **H.R. 4173 § 1105 (a, b, d) (pp. 104-105)**

International competitiveness would also need to be considered under the House Bill. H.R. 4173 § 1105(d)(2) provides that the Council would be required to consider both the need to maintain the international competitiveness of the U.S. financial services industry and the extent to which other countries have established corresponding threat mitigation regimes. **H.R. 4173 § 1105(d)(2) (pp. 106-107)**

13. Early Remediation Requirements

Senate Bill

Under § 166 of the Senate Bill, the Fed, in consultation with the Council and the FDIC, would be authorized to establish requirements to provide for the early remediation of a nonbank financial company supervised by the Fed or a large, interconnected bank holding company experiencing financial distress. This provision would not authorize the Federal government to provide any financial assistance. Instead, the purpose of this provision would be to establish a series of specific remedial actions to be taken by such company experiencing financial distress, in order to minimize the probability that the company will become insolvent and the potential harm of such insolvency to the financial stability of the United States. These provisions are similar to the "prompt corrective action" provisions now applicable to banks. **Senate Bill §§ 166(a)-(b) (pp. 107-108).**

The regulations prescribed by the Fed would define measures of the financial condition of the company, including regulatory capital and liquidity measures and establish requirements that increase in stringency as the financial condition of the company worsens. Such requirements could include limits on capital distributions, acquisitions, and asset growth and—at later stages of financial decline—a capital restoration plan, capital-raising requirements, limits on transactions with affiliates, management changes, and asset sales. **Senate Bill § 166(c) (p. 108).**

House Bill

The House Bill provides that the Fed would be required to take "prompt corrective action" if a financial holding company subject to stricter standards is deemed to be undercapitalized, as defined by the Fed in subsequent regulation. Such an undercapitalized company would be required to submit a capital restoration and could be subject to asset growth restrictions, prior approval for acquisitions, and other discretionary safeguards. If a company was deemed "significantly undercapitalized" or if it failed to implement a capital restoration plan, the Fed would be authorized to place requirements on the company such as capital-raising requirements, limitations on transactions with affiliates, restrictions on asset growth, management changes, and asset sales. **H.R. 4173 § 1104(e).**

14. Exemptions for United States and Foreign Nonbank Financial Companies from Supervision by the Fed

The Fed would be required to set forth the criteria on behalf of, and in consultation with, the Council, for exempting types or classes of nonbank financial companies from supervision by the Fed (pursuant to sections (a) and (b) of Section 113). **Senate Bill §§ 170(a)-(b) (pp. 111-112).** The Fed, again in consultation with the Council, would also be required to review the requirements for exemption every 5 years. Based on this review, the Fed could update its regulations; however, updates would not take effect until two years after their publication in final form. **Senate Bill §§ 170(d)-(e) (p. 112).** The Chairpersons of the Fed and the Council would also be required to submit a joint report to the Senate Banking Committee and the House Financial Services Committee within 30 days of issuing the regulations or updates.

These reports would need to include the rationale for exemption and empirical evidence to support the criteria for exemption. **Senate Bill § 170(f) (pp. 112-113).**

15. Application of Bank Holding Company Act to Nonbank Financial Companies

Senate Bill

The Senate Bill, however, specifically states that nothing in this subtitle would be construed to require a nonbank financial company supervised by the Fed, or a company that controls a nonbank financial company supervised by the Fed, to conform its activities to the requirements of BHC Act § 4. **Senate Bill § 167(a) (pp. 108-109).**

House Bill

Section 6 companies are generally subject to the BHC Act, including section 4, except for grandfathered activities and assets.

16. Fed Authority to Require a Nonbank Financial Company to Establish an Intermediate Holding Company and be Subject to Affiliate Transaction Rules

a) Financial Activities

Senate Bill

The Senate Bill provides that if a nonbank financial company supervised by the Fed conducts activities that are not financial in nature (under BHC Act § 4(k)), the Fed may require the company to establish an intermediate holding company in which it must conduct its financial activities. The intermediate holding company would need be established within 90 days after the nonbank financial company is subject to Fed supervision. **Senate Bill § 167(b) (p. 109).** The Fed must promulgate regulations to establish the criteria for determining whether to require the nonbank financial company to establish an intermediate holding company. **Senate Bill § 167(c)(1) (p. 110).**

The activities determined to be financial in nature under BHC Act § 4(k) will not include internal financial activities, such as internal treasury, investment and employee benefit functions. Further, the current text of Senate Bill § 167 appears to provide that internal financial activities can continue to be conducted by a nonbank financial company outside of the intermediate holding company only if 2/3 of the assets or revenues generated from the activity are from or are attributable to the company and the Fed also determines that engaging in the activities presents no undue risk going forward. **Senate Bill § 167(b)(2) (pp. 109-110).**

House Bill

Under, H.R. 4173 certain nonbank holding companies would be required to establish and maintain a special purpose holding company, to be referred to as a "section 6 holding company." Such companies would include those:

- That are not treated as bank holding companies under BHC Act § 4(f)(1) because on March 5, 1987 they controlled an institution which became a bank as a result of enactment of the Competitive Equality Amendments of 1987 and was not a bank holding company prior to that date;

- That are not treated as bank holding companies because the are described in BHC Act § 4(p)(1) proposed by H.R. 4173; specifically, companies that:

  - on the date of enactment of H.R. 4173 was a unitary savings and loan holding company that continued to control at least one savings association that it controlled on May 4, 1999 (or that it acquired pursuant to an application pending before the OTS on that date) and that became a bank pursuant the BHC Act as a result of H.R. 4173 §1301(a)(3), or on November 23, 2009 controlled an institution that became a bank as a result of the enactment of H.R. 4173 §1301(a)(4)(B), had an application pending before the FDIC that would give it control over an industrial loan company that is federally or State chartered and does not accept demand deposits or maintains total assets of less than $100 million, or controlled an institution it has continuously controlled since March 5, 2987 which became a bank as a result of the Competitive Equality Banking Act of 1987;

  - were not on June 30, 2009 bank holding companies or subject to the BHC Act by reason of § 8(a) of the International Banking Act; and

  - on June 30, 2009 controlled shares or engaged in activities that did not, before enactment of H.R. 4173, comply with the activity or investment restrictions on financial holding companies in BHC Act § 4.

- That are subject to stricter prudential standards under H.R. 4173 § 103, are not a bank holding companies or subject to the BHC Act by reason of § 8(a) of the International Banking Act, and either directly or indirectly control shares or engage in activities that did not, on the date the companies were first subject to heightened prudential standards under H.R. 4173, comply with the activity or investment restrictions on financial holding companies in BHC Act § 4 of in accordance with regulations prescribed by the Board. **H.R. 4173 § 1301(c) (pp. 248-250).**

The section 6 holding company would then be treated as the financial holding company subject to stricter standards. As a general matter, all activities that are "financial in nature" under BHC Act § 4(k) would need to be conducted through the section 6 holding company. Additionally, a section 6 holding company would be prohibited from conducting any nonbanking activities or investing in any nonbanking companies other than those permissible for a financial holding company under sections 3 and 4 of the BHC Act unless the Fed specifically determines otherwise. The Fed would be permitted to make certain exemptions from these rules. **See H.R. 4713 § 1301(c) (pp. 255-257).**

However, a commercial parent could continue to conduct the following activities:

- Internal financial activities conducted for the company or any affiliate, including but not limited to internal treasury, investment, and employee benefits functions, provided that with respect to any internal financial activity engaged in for the company or an affiliate and a nonaffiliated during the year prior to enactment of H.R. 4173, the company (or an affiliate not a subsidiary of the section 6 holding company) can continue to engage in that activity so long as at least two-thirds of the assets or two-thirds of the revenues generated from the activity are from or attributable to the company or an affiliate (subject to review by the Board to determine whether engaging in such activity presents undue risk to the section 6 company or undue systemic risk); and

- Financial activities involving the provision of credit for the purchase or lease of products or services from an affiliate or for the purchase or lease of products produced by an affiliate of such section 6 holding company that is not a subsidiary of the section 6 holding company, in accordance with regulations prescribed by or orders issued by the Board. **H.R. 4173 1301(b)(1) (pp. 232-234).**

Further note that under H.R. 4173, new BHC Act § 6(f) provides that any company that "directly or indirectly" controls a section 6 holding company must serve as a source of financial strength to its subsidiary section 6 holding company. **H.R. 4173 § 1301(c) (p. 264).**

b) Affiliate Transactions

Under the Senate Bill, the Fed may promulgate regulations to establish restrictions or limitations on transactions between an intermediate holding company and the nonbank financial company subject to its supervision, as necessary to prevent unsafe and unsound practices. Such regulations may not, however, restrict or limit any transaction in connection with the bona fide acquisition or lease by an unaffiliated person of assets, goods, or services. **Senate Bill § 167(c)(2) (pp. 110-111).**

Under H.R. 4173, transactions between section 6 holding companies (and any of their nonbank subsidiaries) and any affiliate that is not controlled by the section 6 holding company are subject to the restrictions and limitations contained in §§ 23A and 23B of the Federal Reserve Act as if the section 6 holding company were a member bank. This provision includes a proviso parallel to the Senate Bill, providing that any transaction in connection with the bona fide acquisition or lease by an unaffiliated person of assets, goods, or services is not a covered transaction subject top these rules. **H.R. 4173 § 1301(c) (pp. 260-261).**

TITLE II — RESOLUTION AUTHORITY FOR LARGE, INTERCONNECTED FINANCIAL COMPANIES

A. Overview: Orderly Liquidation Authority

The Senate Bill contains sections that would create a non-Bankruptcy Code framework for providing both financial assistance to help failing and failed bank holding companies and operational assistance in managing the liquidation of such large, systemically connected companies (the "Orderly Liquidation Authority"). The purpose of the Orderly Liquidation Authority is to "provide the necessary authority to liquidate failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard." **Senate Bill § 204(a (pp. 148-149).** The Senate Bill would empower the Treasury to appoint the FDIC as receiver to liquidate a covered financial company (a "CFC"), with broad discretion and power to manage such company and minimize the liquidation's impact on the United States economy.

As proposed, the new liquidation authority would supplant the Bankruptcy Code (the "Code") as the statutory regime for the failure of large, systemically significant financial companies. Most financial companies would operate under the Code. However, if the collapse of a financial company could threaten the United States economy, such company could be placed into the new regulatory regime.

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

Because both the Code and the Senate Bill could apply to the same company, differences between the Code and the Senate Bill are noted below and such *differences are noted in italics.* H.R. 4173 (the "House Bill") also contains provisions for resolving failing and failed bank holding companies. Significant differences between the House Bill's "Enhanced Dissolution Authority" and the Senate Bill are also noted below.

B. Qualifications for a CFC

1. Orderly Liquidation Regime Applicable to Financial Companies

The Senate Bill's liquidation regime would apply to a "financial company," as defined by section 201(a)(10), which includes a company incorporated or organized under federal or any state law that is:

- a bank holding company;

- a nonbank financial company supervised by the Federal Reserve Board (the "Fed") under the Senate Bill;

- a company that is predominantly engaged in activities that the Fed has determined are financial in nature or incidental thereto for purposes of Bank Holding Company Act (the "BHC Act") § 4(k); or

- any subsidiary of the above that is predominantly engaged in activities that the Fed has determined are financial in nature or incidental thereto for purposes of BHC Act § 4(k), other than a subsidiary that is an insured depository institution or insurance company; and

- that is not a Farm Credit System institution, a government entity or a regulated entity, as defined under section 1303 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992. **Senate Bill § 201(a)(10) (as amended by S.A. 3827) (pp. 119-121)**; **H.R. 4173 § 1602(9) (pp. 328-330).**

For a company to be classified as a financial company due to its activities that the Fed has determined are financial in nature or incidental thereto, 85 percent or more of the company's revenue must come from such activities. **Senate Bill § 201(b) (as amended by S.A. 3827) (p. 122).** The FDIC may appoint itself as receiver for any subsidiary (other than an insured depository institution, a CBD or an insurance company) of a CFC if the FDIC and Secretary jointly determine that the subsidiary is in default or in danger of default, treating the subsidiary as a CFC would mitigate the negative effects on the U.S. economy and such action would facilitate the orderly liquidation of the CFC. **Senate Bill § 210(a)(1)(E) (pp. 163-165).**

While the Senate Bill would exclude subsidiaries of a financial company that are insurance companies from the definition of "financial company," insurance holding companies are not excluded and could fall within the purview of the Senate Bill. Insurance companies are resolved under state law, but the FDIC could stand in the place of a state regulatory agency for the resolution of such insurance company under state law if the regulatory agency fails to file for judicial action within 60 days of the FDIC's appointment as receiver. **Senate Bill § 203(e) (pp. 147-148); H.R. 4173 § 1602(9) (pp. 328-330).**

The House Bill would apply to a similar set of financial companies as the Senate Bill, with a few notable differences. Under the House Bill the "financial company" designation under the dissolution regime would apply to a company incorporated or organized under federal or any state law that is:

- a bank holding company;

- a company that has been subjected to heightened prudential regulation under § 1103 of the House Bill;

- an insurance company;

- a company that is predominantly engaged in activities that the Fed has determined are financial in nature or incidental thereto for purposes of BHC Act § 4(k); or
- any subsidiary of the above (other than an insured depository institution, registered broker or dealer);
- and is not a Federal home loan bank or the Federal National Mortgage Home Loan Corporation, a Farm Credit System institution or insured depository institution. **H.R. 4173 § 1602(9) (pp. 328-330).**

Further, the House Bill would require a financial holding company subject to hightened prudential regulation under section 1103 to establish a section 6 holding company to carry out the financial activities of the financial holding company. This would presumably allow the section 6 holding company to be designated as the "financial company" under the dissolution authority. However, it appears that a nonfinancial company which predominantly engages in certain activities would be eligible to be a covered financial company even if it establishes a section 6 holding company. The activities at issue are set forth in section 1103 of the House Bill. That section focuses on whether a company's financial distress or failure, due to the nature, scope, size, scale, concentration and interconnectedness, or mix of the company's activities, could pose a threat to the financial stability or the economy and provides that, in making this determination, the Financial Services Oversight Council will consider the extent of the company's leverage, the extent and nature of the company's off-balance sheet exposures, the extent and nature of the company's transactions and relationships with other financial companies, the company's importance as a source of credit and as a source of liquidity for the financial system, the nature, scope and mix of the company's activities, the amount and nature of the company's liabilities, including the degree of reliance on short-term funding and any other factors that the Council deems appropriate. **H.R. 4173 § 1103 (pp. 46-58).**

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

2. Initiation of Orderly Liquidation Authority

Under the Senate Bill, initiation of the liquidation regime would begin when the FDIC and the Fed make a recommendation as to whether the Secretary of the Treasury (the "Secretary") should appoint the FDIC as receiver for a financial company. The recommendation would be required to include a number of items, including an evaluation of whether a covered financial company is in default or danger of default and a description of the effect that default would have on the financial stability of the United States. The Secretary would then determine, based on the written recommendation and after consultation with the President, whether (a) the financial company is in default or danger of default, (b) the failure of the financial company

would have serious negative effects on U.S. financial stability, (c) private sector alternatives would not prevent the default of the CFC, (d) any effect on the claims and interests of creditors, counterparties and shareholders of the financial company and other market participants would be appropriate given the impact of such actions on the United States economy, (e) actions under the Bill would avoid or mitigate such adverse effects and (f) a federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments. **Senate Bill § 203(a) and (b) (pp. 137-141); H.R. 4173 § 1603 (pp. 331-333).**

If the above standards are met, the Secretary would then petition the District Court of the District of Columbia (the "Court") for an order authorizing the Secretary to appoint the FDIC as receiver of the financial company if the board of directors of the CFC does not acquiesce or consent to the FDIC's appointment. If the Court finds the Secretary's determination is not "arbitrary and capricious" in this hearing, in which the CFC may contest the Secretary's findings, the Court would then issue an order immediately authorizing the Secretary to appoint the FDIC as receiver for the CFC and to commence the resolution process. If the Secretary's determination is "arbitrary and capricious," the Court would immediately provide the Secretary with a written statement of the reasons behind its determination and provide the Secretary an immediate opportunity to amend and refile the petition. If the Court does not make a determination on the petition within 24 hours of its filing, the petition would be granted by operation of law and the liquidation of the CFC would commence. Once the order is granted, the FDIC, as receiver, would resolve the CFC under the Orderly Liquidation Authority. **Senate Bill § 202(a) and (b) (as amended by S.A. 3827) (pp. 123-129).** If the CFC is a broker-dealer ("covered broker or dealer" or "CBD") then the Securities Investor Protection Corporation (the "SIPC") would also be appointed as the trustee and special liquidation rules would apply. **Senate Bill § 205(a) (p. 152); H.R. 4173 § 1602(9) (pp. 328-330).**

The initiation of the resolution regime under the House Bill begins, as with the Senate Bill, with the Secretary's determination to initiate the dissolution regime. However, in contrast to the Senate Bill's *ex ante* judicial oversight of the initiation of the liquidation regime, the House Bill provides *ex post* judicial review of the dissolution regime whereby the CFC may bring an action in any U.S. district court to challenge the appointment of and remove the FDIC as receiver of the CFC. Such challenge must be made within 30 days of the appointment of the receiver and is limited to the FDIC's appointment. **H.R. 4173 §§ 1603 and 1605 (pp. 331-333, 343).**

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

3. Powers of the Receiver on the CFC

Upon initiation of the liquidation proceedings, the Senate Bill would give the FDIC as receiver significant power over a covered financial company. The FDIC, as receiver, could:

- take over the assets and operate the CFC;
- collect all obligations and money due to the CFC;
- perform all functions of the CFC in the company's name;
- manage the assets and property of the CFC;
- provide by contract for assistance in fulfilling any function, activity, action or duty of the receiver;
- merge the CFC with another company;
- provide for the exercise of any function by any member or stockholder, director or officer of the CFC;
- organize a bridge financial company (a "Bridge Company"); or
- transfer any asset or liability of the CFC without any approval, assignment or consent with respect to such transfer. **Senate Bill § 210(a)(1)(B)-(G) (pp.161-167); H.R. 4173 § 1609(a) (pp. 346-356).**

Unlike the Federal Deposit Insurance Act (the "FDIA"), there are no provisions in the Senate Bill that would require the receiver to seek the least costly resolution in the liquidation of an insured depository institution.

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

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

- *paying pre-petition debts;*
- *paying professionals and advisors without a Bankruptcy Court order;*
- *selling assets outside the ordinary course of business;*
- *using cash collateral without the consent of secured creditors or the Bankruptcy Court; and*
- *obtaining credit or incurring secured or unsecured debt without Court approval.*

4. Orderly Liquidation Fund (the "Fund")

The FDIC, as receiver, would have the authority to provide financial assistance to the CFC from a newly established Orderly Liquidation Fund. **Senate Bill § 204(d) (pp. 151-152).** The Fund would be capitalized only after the FDIC is appointed as receiver of a CFC through FDIC-issued debt securities sold to the Treasury. For the first 30 days after the CFC's appointment as receiver, the FDIC would be able to issue obligations of an amount equal to 10 percent of the total consolidated assets of the CFC. After 30 days, the FDIC would be able to issue obligations for an amount that is equal to 90 percent of the fair value of the total consolidated assets of each CFCs that are available for repayment.

Under the Senate Bill, the FDIC must repay the debt securities within 60 months after their issuance to the Treasury. The FDIC would recoup its expenditures from proceeds received through the liquidation process and assessments on claimants and financial companies. Expenditures from the Fund would be classified as administrative expenses or amounts owed to the U.S. government and would have super-priority status among claims of its applicable priority level. Assessments for the Fund would be placed initially on any claimant that received additional payments due to the FDIC's preferential treatment of such claimant in the liquidation process (except for payments or amounts necessary to initiate or continue operations essential to the receivership or any BFC); such preferential treatment is allowed under the Senate Bill if necessary to minimize losses in the liquidation of the CFC. These assessments would equal the amount the claimant received from the FDIC minus the amount the claimant was entitled to recover solely from the liquidation of the CFC under Title II (or the amount the claimant would have received from a chapter 7 liquidation under the Code). If assessments on unequally treated claimants and proceeds from the liquidation process are insufficient to recoup the Fund's expenditures, the FDIC shall issue risk-based assessments on bank holding companies and financial companies with over $50,000,000,000 in consolidated assets and any nonbank financial company supervised by the Fed. **Senate Bill § 210(n) and (o) (as amended by S.A. 3827) (pp. 290-303).**

Under the Senate Bill, the FDIC could require financial companies to make information available to it to enable it to determine the scope of risk-based assessments. The size of an assessment would be based on a risk matrix in which the FDIC must take into account the economic conditions generally affecting financial companies, assessments imposed on the assessed company under the FDIA, SIPC or applicable state insurance law, the financial condition of the financial company including off-balance-sheet exposures, the risks presented by

the financial company to the United States' financial stability, the extent the financial company has benefitted from the orderly liquidation and use of the Fund under the Senate Bill, the different classes of assets or types of financial companies, the parameters of graduated assessments and such other factors as the FDIC deems appropriate. Assessments are imposed on a graduated basis, with financial companies having greater assets assessed at a higher rate. The FDIC would be required, in consultation with the Secretary, to impose rules and regulations to administer assessments. **Senate Bill § 210(n) and (o) (as amended by S.A. 3827) (pp. 290-303); H.R. 4173 § 1609(n) and (o) (pp. 460-476).** The Senate Bill prohibits the use of taxpayer funds from preventing the liquidation of the CFC. **Senate Bill § 214 (as amended by the Boxer amendment to the Senate Bill, S.A. 3737) (pp. 318-319).**

The House Bill, in contrast, would create a System Dissolution Fund (the "Dissolution Fund"), which is capitalized and established *ex ante* before a CFC is placed into the dissolution regime or the appointment of the FDIC as receiver. The Dissolution Fund would be established through *ex ante* risk-based assessments on financial companies and would total $150 billion in size. Risk-based assessments would be imposed on financial companies with over $50 billion in consolidated assets or companies managing a hedge fund with over $10 billion in consolidated assets. In establishing the assessments, the FDIC would differentiate among financial companies to ensure that the assessments charged equitably reflect the risk posed to the Dissolution Fund by the company. There are no explicit prohibitions on the use of taxpayer funds to prevent the liquidation of the CFC under the House Bill. **H.R. 4173 § 1609(n) and (o) (pp. 460-476).**

FDIC Chairman Sheila Bair has expressed a preference for *ex ante* assessments on financial companies to capitalize a resolution fund. She contends that *ex ante* assessments are likely to impose greater discipline on financial companies and are fairer in that companies receiving assistance likely would not end up making payments to the Fund *ex post*.

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

5. Judicial Review from Article III Courts

a) Judicial Review Generally

The Senate Bill would limit the role of courts during the resolution process. In general, "no court may take any action to restrain or affect the exercise of powers or functions of the receiver," unless specifically provided in the Senate Bill. Any remedy against the FDIC would be limited to money damages determined in accordance with the Bill. **Senate Bill § 210(e) (p. 260); H.R. 4173 § 1609(e) (p. 433).**

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

b) Judicial Review of Panel Determinations

As discussed above, the Senate Bill provides for judicial review of the Secretary's determination to commence the Orderly Liquidation Authority by the Court. The Secretary would be required to petition the Court to appoint the FDIC as receiver if the CFC does not acquiesce to the FDIC's appointment as receiver. The Court would evaluate the Secretary's determinations under an arbitrary and capricious standard: if the Secretary's determination is not arbitrary and capricious then the FDIC would be appointed receiver. The Court would be required to make its decision within 24 hours of receipt of the petition; if no decision is made within 24 hours, the FDIC's appointment is automatically granted. The Senate Bill also allows the CFC or the Secretary to file, no later than 30 days after the decision of the Panel, an appeal of the Court's decision to the United States Court of Appeals for the District of Columbia Circuit. A petition for *writ of certiorari* to review a decision by the D.C. Circuit could be filed with the Supreme Court no later than 30 days after the date of the final decision of the Court of Appeals. Review of the Court's determinations by the D.C. Circuit and the Supreme Court would be limited to whether the Secretary's determination that the CFC is in default or in danger of default and that the CFC is a financial company is arbitrary and capricious. **Senate Bill § 202 (as amended by S.A. 3827) (pp. 123-137); H.R. 4173 § 1605 (p. 343).**

As stated above, the House Bill initiates the resolution proceedings solely through the Secretary's determination to initiate the dissolution process and judicial review of such determination is provided *ex post*.

There is no Code analogue to this provision.

c) Judicial Review of Claim Determinations

The Senate Bill would allow a claimant to contest a claim determination by the FDIC in the district court for the district where the principal place of business of the CFC is located. Such claim would need to be brought to the district court within 60 days of the FDIC's allowance or disallowance of the claim. **Senate Bill § 210(a)(4)(A) (p. 179); H.R. 4173 § 1609(a) (pp. 358-366).**

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

6. The Claims Process

At the heart of the dissolution authority is the resolution of creditors' claims against the CFC. All parties with claims against the CFC would be required to present their claims to the FDIC. As the receiver, the FDIC would have the power to determine all claims against the CFC, and could allow or disallow a claim, in part or in whole, which it determines has not been proved to its satisfaction. The FDIC would be required to make such determination within 180 days from the date such claim is presented, although such time may be extended by agreement with the claimant. **Senate Bill § 210(a)(2)-(3) (pp. 172-179); H.R. 4173 § 1609(a)(1)-(4) (pp. 356-365).**

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

a) Secured Claims

The Senate Bill would generally protect security interests granted to secured creditors where the CFC holds the assets or property that is subject to such security interests, and provides that such secured creditors shall be secured up to the fair market value of their collateral. As such, a secured creditor would have the first claim to the fair market value of the assets that secure such creditor's claim. The FDIC would treat the portion of any claim that exceeds the fair market value of such collateral as an unsecured claim, and would not make payment with respect to such unsecured portion other than in connection with a disposition of all unsecured claims.

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

Under the Senate Bill, the FDIC could not reject any legally enforceable or perfected security interest in the assets of the CFC unless such interest was a fraudulent or preferential transfer. The FDIC could not disallow any portion of a legally enforceable or perfected security interest securing an extension of credit from any Federal Reserve Bank or the Treasury Secretary. **Senate Bill §§ 210 (a)(3)(D), 210(c)(12) and 210(d) (pp. 177-178, 251-252, 257-260); H.R. 4173 §§ 1609(a)(4)(D) and 1609(c)(12) (pp. 360-364, 427-428).**

The FDIC could prime a secured creditor's collateral position under the Senate Bill in order to obtain credit for a Bridge Company. However, in doing so the FDIC would be required to provide such creditor with adequate protection, and the FDIC has the burden of proof on whether adequate protection has been provided. **Senate Bill § 210(h)(16) (pp. 262-286); H.R. 4173 § 1609(h)(15) (pp. 454-455).** The Title precludes avoidance of any legally enforceable and perfected interests in customer property. **Senate Bill § 205(d) (pp. 154-155).**

The House Bill treats most secured claims in the same manner as the Senate Bill. However, under the House Bill, if the FDIC determines that there may not be sufficient funds in the estate of the CFC to satisfy all obligations of the Fund or the United States, it may treat any claim arising under a qualified financial contract ("QFC") with an original term of 30 days or less that is secured by collateral (other than government securities) as though it were an unsecured claim in an amount of up to 10 percent of the claim, as necessary to satisfy any amounts owed to the United States or to the Fund. The remaining claim is treated as a fully secured claim. Under this "haircut," a secured creditor under certain QFCs could receive an allowed secured claim for as little as 90 percent of its total claim (secured by the value of its collateral) and an allowed general unsecured claim for the remainder, which could be as much as 10 percent. The general unsecured claimant would receive whatever distribution would otherwise be available to a general unsecured claim under the House Bill. The haircut was added to the House Bill in order to ensure creditors "keep skin in the game." **H.R. 4173 § 1609(a)(4)(D)(iv) (pp. 360-364).**

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

b) Unsecured Claims

The Senate Bill would create a priority structure for unsecured claims similar to that in the FDIA. Unsecured claims would have the following priority, in descending order:

- administrative expenses of the receiver;
- any amounts owed to the United States;
- wages, salaries, or commissions earned not later than 180 days before the date of appointment of the FDIC as receiver ($11,725 per individual);
- contributions owed to employee benefit plans arising from services rendered not later than 180 days before the date of appointment of the FDIC as receiver ($11,725 per individual);
- general or senior liabilities of the CFC;
- obligations subordinated to general creditors;
- any wages, salaries or commissions owed to senior executives and directors of the covered financial company;

- obligations to persons with interests in the equity of the CFC as a result of their status as a shareholder, member, etc.

As discussed above, the Senate Bill would give priority to claims of the United States against the CFC over other unsecured creditors. In addition, any amounts owed to the FDIC from expenditures from the Fund will be given super-priority status among all unsecured creditors. **Senate Bill § 204(d) (as amended by S.A. 3827) (pp. 151-152).** Similarly situated creditors for each type of unsecured claim would be treated similarly unless the FDIC determines that dissimilar treatment is necessary to maximize the value of the CFC's assets, maximize the present value return from the sale of assets or minimize losses to the CFC's assets. **Senate Bill § 210(b) (pp. 204-209); H.R. 4173 § 1609(b) (pp. 385-389).** The Senate Bill would allow any obligation "necessary and appropriate" for the smooth resolution of the CFC to qualify as an administrative expense, which is given the highest priority level among unsecured creditors. **Senate Bill § 201(a)(1) (p. 117); H.R. 4173 § 1609(b)(6) (pp. 388-389).** All similarly situated creditors would receive not less than the amount they would receive under a chapter 7 liquidation (as discussed below). **Senate Bill § 210(d)(2) (pp. 257-258); H.R. 4173 § 1609(d)(2) (pp. 431-432).**

The House Bill has a very similar priority scheme for unsecured creditors. The House Bill does differ from the Senate Bill in that the House Bill does not provide for a 180-day limit on wages, salaries or commissions or contributions owed to employee benefit plans. In addition, the House Bill treats wages, salaries or commissions owed to senior executives and directors of a CFC in the same manner and priority level as other wages, salaries or commissions. The House Bill is also silent as to the priority level expenditures from the Dissolution Fund would receive, although it would presumably classify as amounts owed to the United States. Under the House Bill, unsecured claims have the following priority, in descending order:

- administrative expenses of the receiver;
- amounts owed to the United States;
- wages, salaries or commissions;
- contributions to employee benefit plans;
- general or senior liabilities of the company;
- subordinated obligations to general creditors;
- obligations to persons with interests in the equity of the company as a result of their status as a shareholder, member, etc. **H.R. 4173 § 1609(b)(1) (pp. 385-389).**

There are significant differences in the treatment of unsecured claims under the Senate Bill and the Code. The first significant difference relates to the guidance provided in each statute as to what is an allowable claim. The Code has numerous statutory provisions that provide parameters for what claims will be allowed and, in some instances, limitations on the amounts for which such claims will be allowed. A deep body of precedent provides further

guidance on these parameters. No similar provisions or precedent exist relative to the Senate Bill. The Code's guidance on claims lends more certainty and transparency to the Code's procedures than to those under the Senate Bill.

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

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

c) Valuation of Claims

The Senate Bill would establish that the maximum liability to any person having a claim against the CFC will be the amount such claimant would have received in a chapter 7 liquidation under the Code or state insolvency law and the CFC had not been subject to the Orderly Liquidation Authority (the "Liquidation Amount"). The Senate Bill does not identify the methodology used to value the collateral, nor does it provide any other rights for creditors to fully participate in the process, including disputes over the amount a creditor would receive from the liquidation of the assets. The FDIC could make additional payments to a claimant if the FDIC determines that such actions would minimize losses to the FDIC as receiver. **Senate Bill § 210(d)(2) (pp. 257-258); H.R. 4173 § 1609(d)(2) (pp. 431-432).** The House Bill sets the Liquidation Amount at the amount the claimant would receive under the Code or state insolvency law and does not explicitly place the Liquidation Amount at the amount a claimant would receiver under chapter 7 liquidation. **H.R. 4173 § 1609(d)(2) (pp. 431-432).**

The Senate Bill contains special provisions for the valuation of customer claims in the resolution of a CBD. The Senate Bill would resolve all customer claims of CBDs in the same manner and for the same amount as the Securities Investor Protection Act (the "SIPA"). Any obligation of a CBD to a customer relating to customer property would be paid in an amount that is at least as beneficial to the customer as if the CBD had been subject to a proceeding under the SIPA or by delivering the securities to the customer. **Senate Bill § 205(f) (pp. 155-157).**

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

7. Contracts

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

The FDIC would be able to enforce any contract (other than a financial institution bond or a director and officer insurance contract) and require performance by the counterparty of its contractual obligations despite termination rights due to the insolvency or financial condition of the company (*ipso facto* provisions). Further, for the first 90 days of a receivership, the other party to a contract with a CFC would not be able to exercise any right to terminate, accelerate or declare a default to the contract or obtain possession or control over any property of the CFC without the FDIC's consent; such "hold" would not apply to director or officer liability insurance contracts, financial institution bonds, the rights of parties to certain QFCs or certain contracts under the FDIC Improvement Act. The FDIC, however, could not reinstate a contract that was terminated before the appointment of the FDIC. **Senate Bill § 210(c) (pp. 209-257); H.R. 4173 § 1609(c) (pp. 389-431).**

The Senate Bill would also adopt a less stringent version of the *D'Oench Duhme* doctrine, codified in the FDIA, to contracts against the interest of the FDIC. Under the Senate Bill, any agreement that tends to diminish or defeat the interest of the FDIC as receiver in any asset acquired by the FDIC would not be valid unless the agreement (a) is in writing, (b) was executed by an authorized officer or representative of or confirmed in the ordinary course of business by the CFC and (c) has been an official record of the CFC since the time of its execution or the party claiming under the agreement provides documentation of such agreement and its authorized execution by the CFC. **Senate Bill § 210(a)(6) (pp. 183-184); H.R. 4173 § 1609(a)(7) (p. 369).**

Under the Code, if a contract is rejected, it will give rise to a pre-petition unsecured claim for damages, which may be paid pro rata rather than in full. Rejection of claims for some types of contracts, such as long-term leases and employment contracts, are limited in terms of the amount that will be allowed. Executory contracts first assumed by a debtor but subsequently rejected give rise to an administrative claim for a portion of the damages. The Code does not

mirror the D'Oench Duhme doctrine's contract requirements and contracts not in writing or authorized by an officer of the CFC may be enforceable. Unlike the Senate Bill, the Code prevents the assignment of certain types of contracts, including contracts where applicable law excuses a party from accepting performance from or rendering performance to a debtor and contracts for financial accommodations, without consent of the non-debtor party. Similarly, the Code has specific provisions to ensure that, prior to assuming and assigning contracts, the debtor must cure all defaults, compensate for damages and provide adequate assurance of future performance. No such protections exist under the Senate Bill.

8. Qualified Financial Contracts ("QFCs")

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

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

Under the Senate Bill, the FDIC could not avoid a transfer of money or property in connection with any QFC unless the transferee had actual intent to hinder, delay or defraud the CFC, creditors or receiver of the CFC. The Senate Bill would allow preference and fraudulent conveyance challenges to QFCs, as well as challenges for set-off rights. Damages for repudiated QFCs would include normal and reasonable costs of cover or other reasonable measure of damages used in the industry. **Senate Bill § 210(c)(8)-(11) (pp. 219-251); H.R. 4173 § 1609(c)(8)-(11) (pp. 398-427).**

The Code provides "safe harbors" for QFCs and QFC counterparties. Non-debtor counterparties may, immediately and without seeking relief from the automatic stay, exercise

their contractual rights under QFCs to (i) terminate or accelerate the obligations of the parties and liquidate and realize against any collateral held to secure the debtor's obligations and (ii) set off mutual debts and claims. These rights would typically be restricted under the Code in order to protect the estate of the debtor. In addition, any deliveries or settlements made pursuant to these QFCs are protected from being avoided as either preferential or fraudulent transfers, provided that they were not made with an intent to defraud.

9. Bridge Financial Companies ("Bridge Companies")

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

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

The Senate Bill would require the FDIC to treat all similarly situated creditors of the CFC equally when transferring the assets or liabilities of the company to a Bridge Company, unless unequal treatment is necessary to maximize the value of assets and the present value of return from the sale of assets, minimize the amount of any loss from the sale of assets or contain any serious adverse effects to the United States economy. All such similarly situated creditors would receive at least the Liquidation Amount. The Senate Bill could create uncertainty for creditors because the FDIC may transfer their claims or the assets securing their claims to a Bridge Company for less than fair value or, in the case of a secured creditor, without adequate protection of such creditor's secured claim. The Senate Bill does not provide any methodologies or judicial review for valuing claims or collateral securing such claims or any process to contest the values assigned by the FDIC. **Senate Bill § 210(h) (pp. 262-286); H.R. 4173 § 1609(h) (pp. 435-456).**

The Code does not contain the concept of a Bridge Company to hold assets. However, often a plan of reorganization will distribute certain assets to a liquidating trust, which will

liquidate those assets and distribute them as provided in the plan. Generally, a liquidating trust holds primarily non-operating assets and litigation claims and not the operating assets of a business.

10. Fraudulent Transfers

The Senate Bill generally provides that the FDIC cannot avoid any otherwise legally enforceable or perfected security interest in any of the CFC's assets unless such interest was taken in contemplation of the CFC's insolvency or with the intent to hinder, delay or defraud the institution or its creditors, or any legally enforceable interest in customer property. It is unclear what actions would constitute "in contemplation of insolvency." **Senate Bill § 210(c)(12) (pp. 190-192); H.R. 4173 § 1609(c)(12) (pp. 427-428).**

However, the Senate Bill would allow the FDIC to avoid a transfer of any interest of the CFC in property or obligation that is a fraudulent transfer. A transfer would be deemed fraudulent if it was made (a) within two years before the appointment of the FDIC as the receiver, (b) with the intent to hinder, delay or defraud the CFC or FDIC and (c) when the CFC was insolvent or became insolvent as a result of the transfer, such transfer would have resulted in an unreasonably small amount of capital remaining with the CFC, such transfer involved debts that would be beyond the CFC's ability to pay or such transfer was made to or for the benefit of an insider.

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

A transferee would have the defenses provided under sections 546(b) and (c), 547(c) and 548(c) of the Code. Transfers exempt from avoidance from these defenses would include those made with certain perfected security interests, made in the reclamation of goods by a seller, that are contemporaneous exchanges for new value and with transferees that take the transfer for value and in good faith. The Senate Bill does not provide the defenses available under section 546(e) of the Code. That section, among other things, protects from avoidance settlement payments. **Senate Bill § 210(a)(11) (pp. 190-196).**

Under the House Bill, the FDIC may avoid a transfer of interest that was made within five years of the FDIC's appointment as receiver if the person who made the transfer did so with the intent to hinder, defraud or delay the CFC or the FDIC. Unlike the Senate Bill, the House Bill does not require that the transfer be made when the CFC was insolvent or became insolvent as a result of the transfer, such transfer would have resulted in an unreasonably small amount of capital remaining with the CFC, such transfer involved debts that would be beyond the CFC's ability to pay or such transfer was made to or for the benefit of an insider. A transferee can claim any affirmative defenses and rights to liens on the property transferred available under sections 547, 548 and 540 of the Code, which sections cover preferences, fraudulent transfers and post-petition transactions. The rights of the FDIC to avoid fraudulent transfers are subject to the same limitations as a trustee in a bankruptcy proceeding under 546(b)(1) of the Code, which provides that the rights of the trustee are subject to any applicable law that (a) permits perfection

of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection or (b) provides for the maintenance or continuation of perfection of an interest in property to be effective against an entity that acquires rights in such property before the date on which action is taken to effect such maintenance or continuation. Other defenses available under section 546 of the Code, such as those provided under 546(c), are not available to transferees under the House Bill.. **H.R. 4173 § 1609(a)(12) (pp. 375-382).**

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

11. Preferential Transfers

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

The FDIC could recover the property transferred or value of the property from the initial transferee or from any immediate or mediate transferee. The FDIC could not recover from any initial transferee that takes for value, without knowledge of the transfer's potential voidability or any immediate or mediate good faith transferee of such initial transferee. A transferee would have the defenses provided under sections 546(b) and (c), 547(c) and 548(c) of the Bankruptcy Code, noted above. **Senate Bill § 210(a)(11) (pp. 190-196); H.R. 4173 § 1609(a)(12) (pp. 376-382).**

The House Bill allows the FDIC to avoid preferential transfers in the same manner as the Senate Bill. In addition, the House Bill generally provides that the FDIC cannot avoid any otherwise legally enforceable or perfected security interest in any of the company's assets unless such interest was taken in contemplation of the CFC's insolvency or with the intent to hinder, delay or defraud the institution or its creditors, or any legally enforceable interest in customer property. **H.R. 4173 § 1609(c)(12) (pp. 427-428).** The House Bill does not define what actions would constitute "in contemplation of insolvency." A transferee can claim any affirmative defense available under the Code for preferences, fraudulent transfers and postpetition transactions. **H.R. 4173 § 1609(a)(12)(F) (pp. 378-379).**

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

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

12. Set-Off Rights

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

The FDIC, however, would be able to object to any portion of any set off that is not proven to its satisfaction. Further, the FDIC would be able to sell or transfer any assets free and clear of any set-off rights of a party. And, although the party with set-off rights would be entitled to a claim equal to the value of such set-off right, such claim would be subordinate to all but subordinated unsecured liabilities of the CFC. **Senate Bill § 210(a)(12) (pp. 196-200).**

The House Bill contains no provisions that grant creditors set-off rights.

The same creditor has far greater protections under the Code. While the set-off rules are largely the same, i.e., the requirement for mutually and the limitations on the right of set off, under the Code a party with set-off rights is treated much the same as a secured creditor. Unlike the Senate Bill, set-off rights cannot be evaded by sale or transfer of an asset free and clear of set-off rights and there is no concept of subordination of a valid set-off claim.

13. Liquidation of Covered Brokers and Dealers ("CBDs")

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

All customer claims of CBDs would be resolved in the same manner and for the same amount as under the SIPA. Any obligation of a CBD to a customer relating to customer property would be paid in an amount that is at least as beneficial to the customer as if the CBD had been subject to a proceeding under the SIPA or by delivering the securities to the customer. **Senate Bill § 205 (pp. 152-157).** The Senate Bill sets the maximum liability for a customer of a CBD at the amount the customer would have received from its customer property in a case initiated by the SIPC under the SIPA, determined on the close of business of the day the FDIC is appointed as receiver. **Senate Bill § 210(d)(3) (p. 258).**

The House Bill differs from the Senate Bill in its resolution of broker-dealers. The House Bill requires the appointment of the Securities Exchange Commission (the "SEC") rather than the FDIC as the receiver for a failed or failing broker-dealer. The SEC would otherwise dissolve the broker-dealer as other CFCs are dissolved under the House Bill. **H.R. 4173 § 1602 (pp. 325-326).**

14. Mandatory Terms for All Orderly Liquidations

The Senate Bill would require the FDIC, in taking any action under the Orderly Liquidation Authority, to (a) determine that such action is necessary for the financial stability of the United States, (b) ensure that the shareholders of the CFC do not receive payment until all other claims and the Fund are paid, (c) ensure that unsecured creditors bear losses in accordance with their priority order, (d) ensure that the management responsible for the failed condition of the CFC is removed and (e) not take an equity interest in the CFC. **Senate Bill § 206 (p. 158).** The House Bill contains no mandatory terms for the dissolution of a CFC.

15. Recoupment of Senior Executive and Director Compensation

The Senate Bill would allow the FDIC to recover from any current or former executive or director substantially responsible for the failed condition of the CFC any compensation received from 2 years prior to appointment of the FDIC as receiver. In cases of fraud, no time limit would exist for the FDIC's ability to recover such compensation. **Senate Bill § 210(s) (as amended by S.A. 3827) (p. 308).** The House Bill contains no such mechanism for the recoupment of executive or director compensation.

16. Reporting Requirements

The Senate Bill would require several reports:

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

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

- The Comptroller General would be required to conduct a study regarding international coordination relating to the liquidation of financial companies under the Bankruptcy Code.

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

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

- The Inspector General of the CFC's primary federal regulatory agency or the Fed (if no federal regulatory agency exists) would issue a written report evaluating the effectiveness of the agency or the Fed in supervising the CFC. **Senate Bill §§ 202(e)-(g), 203(c) (as amended by S.A. 3827) (pp. 133-137, 141-147).**

The House Bill would require only two studies under the dissolution regime:

- The Comptroller General would conduct a study on the safe harbor provisions under federal law for derivatives, swaps and securities transactions, which would include an analysis on whether the provisions impede a debtor's ability to rehabilitate or reorganize and the effect such provisions have had on the financial marketplace.

- The Treasury would conduct a study on how the resolution authority provided under sections 1601 to 1617 of the House Bill should be funded. The study must be submitted to Congress within six months of the enactment of the House Bill. **H.R. 4173 §§ 1615, 1616 (pp. 501-504).**

TITLE III — OTS-OCC MERGER AND REGULATION OF SAVINGS ASSOCIATIONS

Under current law, the Office of Thrift Supervision (OTS) is the Federal bank regulator and overseer of all Federal and most state-chartered thrift institutions, as well as their holding companies. Both bills would abolish the OTS. The Senate Bill transfers its functions to the Fed, the OCC, and the FDIC. The stated purpose of such changes are: (1) to provide for the safe and sound operation of the United States banking system; (2) to preserve and protect the dual system of Federal and State-chartered depository institutions; (3) to ensure the fair and appropriate supervision of each depository institution; and (4) to streamline and rationalize the supervision of depository institutions and their holding companies. **Senate Bill § 301 (p. 319).**

The division of OTS' functions in the Senate Bill largely mirrors that in the House Bill. Under H.R. 4173, the OCC would assume all former responsibilities and authorities of the OTS other than those with respect to savings and loan holding companies and state savings associations. The Fed would be responsible for all former OTS authorities (including rulemaking) related to savings and loan holding companies, while the FDIC would assume functions related to the regulation of state savings associations. **H.R. 4173 §§ 1204, 1207, 1256.**

A. Transfer of OTS' Functions Related to Savings and Loan Holding Companies

1. Supervision of S&L Holding Companies

The Senate Bill, as amended by S.A. 3759, offered by Senator Hutchinson, would transfer all functions of the OTS related to the supervision of any savings and loan company and any subsidiary (other than a depository institution) of a savings and loan holding company to the Fed. **Senate Bill§ 312(b), as amended by S.A. 3759 (pp. 321-323).**

H.R. 4173 would also transfer all functions of the OTS related to the supervision of savings and loan holding companies to the Fed, including those that are predominantly engaged in the business of insurance. **H.R. 4173 § 1204(a) (pp. 146-148).**

2. Rulemaking Authority Over S&L Holding Companies

The Fed alone would succeed to the rulemaking authority of the OTS with respect to all savings and loan holding companies. **Senate Bill § 312(b)(1)(B) (p. 322).** The Fed would also assume the OTS's rulemaking authority under section 11 of the Home Owners' Loan Act (12 U.S.C.. § 1468) relating to transactions with affiliates and extensions of credit to executive officers, directors, and principal shareholders. **Senate Bill § 312(b)(2)(A) (p. 322).**

B. Transfer of OTS's Functions Related to Savings Associations

1. Supervision of Federal and State Savings Associations

Under the Senate Bill, all functions of OTS and the Director of OTS relating to Federal savings associations would be transferred to the Comptroller of the Currency. **Senate Bill § 312(b)(2)(B) (pp. 322-323).**

The FDIC would assume all functions of the OTS and the Director of OTS relating to State savings associations. **Senate Bill § 312(b)(2)(C) (p. 323).**

The same division of authority would apply under the House Bill.

2. Rulemaking Authority Over Savings Associations

The Senate Bill provides that the Comptroller of the Currency would assume all rulemaking authority relating to savings associations. **Senate Bill § 312(b)(2)(D) (p. 323).**

C. Appropriate Federal Banking Agency

1. The Comptroller of the Currency

The Senate Bill would amend Section of the FDI Act (12 U.S.C. § 1813), subsection (q) so as to make the Comptroller of the Currency the "appropriate federal banking agency" in the case of any national banking association; any Federal branch or agency of a foreign bank; and any Federal savings association. **Senate Bill § 312(c)(1) (pp. 323-324); H.R. 4173 § 1204(b) (pp. 148-149).**

2. The FDIC

The FDIC would become the "appropriate federal banking agency" in the case of any insured State bank; any foreign bank having an insured branch; and any State savings association **Senate Bill § 312(c)(1) (p. 324); H.R. 4173 § 1204(b).**

3. The Fed

Further amendments to the FDI Act would provide that the Fed would be the "appropriate federal banking agency" in the case of any State member bank; any branch or agency of a foreign bank with respect to any provision of the Federal Reserve Act which is made applicable under the International Banking Act of 1978; any foreign bank which does not operate an insured branch; any agency or commercial lending company other than a Federal agency; supervisory or regulatory proceedings arising from the authority given to the Fed under section 7(c)(1) of the International Banking Act; any bank holding company and its subsidiaries (other than depository institutions); and any savings and loan holding and its subsidiaries. **Senate Bill § 312(c)(1) (pp. 324-325); H.R. 4173 § 1204(b).**

D. Application of the Federal Deposit Insurance Act

Section 8(b)(3) of the FDI Act would be amended so that subsections (c) through (s) and subsection (u) of Section 8 and Section 50 would apply to: (1) any bank holding company and its subsidiaries (other than depository institutions) as if such company or subsidiary was an insured depository institution for which the appropriate Federal banking agency for the bank holding company was the appropriate Federal banking agency; (2) any savings and loan holding company and its subsidiaries (other than depository institutions) as if such company or subsidiary was an insured depository institution for which the appropriate Federal banking agency for the savings and loan company was the appropriate Federal banking agency; and (3) any organization organized and operated under Section 25A of the Federal Reserve Act or operating under Section 25 of the Federal Reserve Act, as if such organization was a bank holding company for which the Fed was the appropriate Federal Banking Agency. **Senate Bill § 312(c)(2) (pp. 325-327.**

E. Transfer Date of the Functions of the OTS

The Senate Bill sets the date for the transfer of functions to the OCC, the FDIC and the Fed as one year after the date of enactment of Title I of the Act. **Senate Bill § 311(a) (p. 320); H.R. 4173 § 1205(a).**

An extension would permitted if the Secretary, in consultation with the Comptroller and the Director of the OTS, transmits a request for such an extension to the Senate Banking Committee and House Financial Services Committee. The request would need to include a written determination that "orderly implementation" of this subtitle is not feasible within the established time frame, an explanation of why the extension is necessary, and a description of the steps that will be taken to effect the implementation of the power transfer within the extended time period. In no case would the date for power transfer be later than 18 months after the Title's enactment. **Senate Bill § 311(b) (pp. 320-321); H.R. 4173 § 1205(b) .**

F. Office of the Comptroller of the Currency as Successor to the OTS

1. Abolishment of OTS

The Senate Bill would abolish the Office of Thrift Supervision (OTS) and the position of Director of OTS. This provision would be effective 90 days after the transfer date. **Senate Bill § 313 (p. 328); H.R. 4173 § 1207.**

2. Office of the Comptroller of the Currency

Under the Senate Bill, Section 324 of the Revised Statutes of the United States would be restated to reflect the transfer of OTS authority to the OCC. The OCC would remain a bureau in the Department of the Treasury. It would be charged "with assuring the safety and soundness of, and compliance with laws and regulations, fair access to financial services, and fair treatment of customers, by the institutions an other persons subject to its jurisdiction." As now, the chief officer of the OCC would be the Comptroller of the Currency, who will perform his/her duties under the general direction of the Secretary of the Treasury. Upon the transfer date, the

Comptroller would be vested with the same authority as was previously vested in the Director of OTS. **Senate Bill § 314 (pp. 328-329).**

3. Savings Provisions

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

The transfer of powers away from OTS would not affect the validity of any right, duty, or obligation of the United States, the Director of OTS, the OTS, or any other person that existed on the day before the transfer. **Senate Bill § 316(a)(1) (p. 330); H.R. 4173 § 1208(a)(1).**

Furthermore, the Senate Bill makes clear that the subtitle transferring powers would not abate any action or proceeding commenced by or against the OTS or its Director. However, for any action or proceeding arising out of a function of the OTS Director that is transferred to the Comptroller, the Comptroller would need to be substituted for the OTS or its Director as a party to the action or proceeding as of the transfer date. The same is said for the FDIC and the Fed related to those powers which it assumes from OTS—if there is an action or proceeding related to these powers, the Chairperson of the FDIC or the Chairman of the Fed would have to be substituted for the Director of the OTS as a party to the action. **Senate Bill § 316(a)(2) (pp. 330-331); H.R. 4173 § 1208(a)(2).**

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

All orders, resolutions, determinations, agreements, regulations, interpretative rules, guidelines, procedures, and other advisory materials that have been issued, made, prescribed, or allowed to become effective by the OTS or the Fed (or by a court of competent jurisdiction) and that relate to the functions transferred by the Senate Bill and are in effect on the day before the transfer date would continue in effect according to their terms. Further, such actions would be enforceable by and against the OCC, the Fed, and the FDIC (with respect to the OTS powers transferred to each of these entities) until modified, terminated, set aside or superseded in accordance with applicable law by the OCC, the Fed, the FDCI, a court of competent jurisdiction, or the operation of law. **Senate Bill § 316(b) (pp. 331-332); H.R. 4173 § 1208(b).**

c) Continuation of Regulations

Before the transfer date, the Comptroller of the Currency, after consulting with the Chairperson of the FDIC, would be required to identify the regulations that will continue to be enforced by the OCC and publish a list of such regulations. Likewise, the FDIC and the Fed would, in consultation with the Comptroller, identify those regulations that will be enforced by the FDIC and the Fed and publish a list of such regulations. **Senate Bill § 316(c) (pp. 332-333); H.R. 4173 § 1208(d).**

Regulations that have been proposed by the OTS before the transfer date, but have not yet been published as final regulation, would be deemed to be a proposed regulation of the OCC, the FDIC, or the Fed, as appropriate. With respect to interim or final regulations that the OTS has published before the transfer date but have not yet become effective, they would become

effective as a regulation of the OCC or the FDIC, as appropriate. **Senate Bill § 316(d) (p. 333); H.R. 4173 § 1208(e) – (f).**

d) References in Federal Law to Federal Banking Agencies

Any reference in Federal law to the Director of the OTS or the OTS would be deemed a reference to the Comptroller of the Currency, the OCC, the Chairperson of the FDIC, the FDIC, the Chairman of the Fed, or the Fed, as appropriate, except as provided in Senate Bill Section 213(d)(2),as to changes in the BHC Act **Senate Bill § 317 (p. 334).**

4. Funding and Assessments

The Senate Bill would amend current law to allow the Comptroller to collect an assessment, fee, or other charge from any entity described in section 3(q)(1) of the FDI Act, as the Comptroller determines necessary or appropriate to carry out the responsibilities of the OCC. The Comptroller could also collect such fees from entities whose activities it supervises under section 6 of the BHC Act. In establishing the amount of such an assessment, the Comptroller could take into account the funds transferred to the OCC under this section, the nature and scope of activities of the entity, the amount and type of assets that entity holds, the financial and managerial condition of the entity, and any other factor, as the Comptroller determines appropriate. The Comptroller alone would have the authority to determine the manner in which the obligations of the Office will be incurred and its disbursements and expenses allowed to be paid. **Senate Bill § 318(a) (pp. 334-335).**

The Senate Bill also would amend the Federal Reserve Act, directing the Fed to collect the total amount of assessments, fees or other charges from (1) bank holding companies with total consolidated assets of $50 billion or more; (2) savings and loan holding companies with $50 billion or more; and (3) all nonbank financial companies supervised by the Fed under section 113 of this Act. **Senate Bill § 318(b) (pp. 335-336).**

The cost of conducting any regular or special examination of any depository institution could be assessed by the FDIC against the institution to meet the FDIC's expenses, or as the FDIC determines is necessary or appropriate to carry out its responsibilities. The FDIC would also be permitted to collect an assessment fee or other change from any entity whose activities are supervised by the FDIC under Section 6 of the BHC Act. **Senate Bill § 318(c) (pp. 336-337).**

These amendments would take effect on the transfer date. **Senate Bill § 318(d) (p. 337).**

5. Administrative Provisions Related to the Transfer

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

- Coordination of transition activities **(Senate Bill § 321)**;
- Interim responsibilities **(Senate Bill § 321)**;

- Transfer of employees **(Senate Bill § 322)**;
- Transfer of property **(Senate Bill § 323)**;
- Transfer of funds **(Senate Bill § 324)**;
- Disposition of the OTS's affairs **(Senate Bill § 325)**;
- Continuation of services provided to the OTS by other United States agencies or departments to the OCC **(Senate Bill § 326)**; and
- Contracting and leasing authority of Comptroller **(Senate Bill § 319)**.

H.R. 4173 §§ 1210-1217 (pp. 157-178) contains similar provisions**.**

G. Reforms to FDIC Assessments

1. Size Distinctions

The Senate Bill would eliminate Section 7(b)(2)(D) of the FDI Act, which prohibits discrimination based on size. Section 7(b)(2)(D) currently states that "no insured depository institution shall be barred from the lowest-risk category solely because of size." **Senate Bill § 331(a) (p. 360).**

2. Assessment Base

Under the Senate Bill, the FDIC would be required to amend the way in which it calculates an assessment base with regards to an insured depository institution for the purposes of Section 7(b)(2) of the FDI Act. Namely, the assessment base would be equal to the average total consolidated assets of the insured depository institution during the assessment period, minus the sum of the average tangible equity of the insured depository institution during the assessment period; and, in the case of a custodial bank (as defined by the FDIC based on factors including the percentage of total revenues generated by custodial businesses) or a banker's bank (as that term is used in 12 U.S.C. § 24), an amount that the FDIC determines is necessary to establish assessments consistent with the definition under Section 7(b)(1) of the FDI Act of a custodial bank or banker's bank. **Senate Bill § 331(b), as amended by S.A. 3749 (pp. 360-361).**

3. Composition of Board of Directors of the Federal Deposit Insurance Corporation

The Senate Bill amends Section 2 of the FDI Act so as to replace the Director of the OTS with the Director of the Consumer Financial Protection Bureau on the Board of Directors of the FDIC. Further, in the event of a vacancy in the office of the Comptroller of the Currency, the acting Comptroller will be a member of the Board of Directors. **Senate Bill § 332 (p. 362); H.R. 4173 § 1221.**

H. Termination of Federal Thrift Charter

1. Termination of Federal Savings Associations

Beginning on the date that the Senate Bill is enacted into law, the Director of OTS or the Comptroller would not be permitted to issue a charter of a Federal savings association under Section 5 of the Home Owner's Loan Act. Conforming amendments would be made to the Home Owner's Loan Act. The Comptroller would be authorized to provide for the examination, operation, and regulation of Federal savings associations (including Federal savings banks), giving primary consideration to the best practices of thrift institutions. When the Comptroller determines that no Federal savings associations exist, Section 5 of the Home Owner's Loan Act would be repealed. **Senate Bill § 341 (pp. 363-364).**

2. Branching

Under the Senate Bill, notwithstanding the FDI Act, the BHC Act, or any other provision of Federal or State law, a savings association that becomes a bank could continue to operate any branch or agency that the savings association operated immediately before the savings association became a bank. **Senate Bill § 342 (p. 364).**

TITLE IV — REGULATION OF ADVISERS TO HEDGE FUNDS

Title IV of the Senate Bill, set forth as the "Private Fund Investment Advisers Registration Act of 2010" (the "PFIARA"), would require that investment advisers to hedge funds and certain other private funds to register with the Securities and Exchange Commission (the "SEC") and comply with substantive requirements. The Senate Bill would provide exemptions for advisers to venture funds, most private equity funds, and family offices, foreign private advisers with fewer than 15 clients, and a limited intrastate exemption. With limited exceptions, as discussed below, the Senate Bill is substantively similar to H.R. 4173, Title V, Subtitle A, "The Private Fund Investment Advisers Registration Act of 2009".

A. Exemptions

1. Elimination of Private Adviser Exemption

The Senate Bill, like H.R. 4173, would amend section 203(b)(3) of the Investment Advisers Act of 1940 (the "Advisers Act") to eliminate the 15 or fewer client exemption that currently allows many private equity fund and hedge fund advisers to avoid registration with the SEC. Section 203(b)(3) would not allow an investment adviser who acts as an investment adviser to any private fund to forego registration. **Senate Bill § 403 (p. 366); H.R. 4173 § 5003 (p. 1203).** Like the House Bill, the Senate Bill defines a "private fund" as an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (the "1940 Act"), but for section 3(c)(1) or 3(c)(7) thereof. **Senate Bill § 402 (p. 364-65); H.R. 4173 § 5002 (p. 1202).**

Both bills would prohibit the SEC from defining the term "client" for purposes of the Advisers Act's antifraud provision, Section 206, to include an investor in a private fund managed by an investment adviser if the fund has entered into an advisory contract with the adviser. **Senate Bill § 406 (p. 375). H.R. 4173 § 5008 (p. 1214).**

2. Limited Foreign Private Adviser Exemption

As with the House Bill, the Senate Bill would also strike the current language of Section 203(b)(3) of the Advisers Act, and add language that exempts from registration "any investment adviser that is a foreign private fund adviser." **Senate Bill § 403 (p. 366-67); H.R. 4173 § 5003 (p. 1203).** The Senate Bill defines "foreign private fund adviser" as an investment adviser who:

- has no place of business in the United States;
- has fewer than 15 clients who are domiciled in or residents of the United States
- has assets under management ("AUM") attributable to clients who are domiciled in or resident of the United States of less than $25 million, or such higher amount as the SEC may deem appropriate; and
- neither holds itself out generally to the public in the United States as an investment adviser; nor acts as an investment adviser to (i) any investment company registered

under the 1940 Act, or (ii) a company that has elected to be a business development company under the 1940 Act (a "Business Development Company"). **Senate Bill § 402 (pp. 365-366).**

The House Bill's definition of foreign private fund adviser is nearly identical, except that under its definition the foreign private fund adviser must have an AUM attributable to United States clients and investors *in private funds advised by the investment adviser* of less than $25 million. **H.R. 4173 § 5002.**

3. Limited Intrastate Exemption

Like the House Bill, the Senate Bill would also amend the existing intrastate exemption found in Section 203(b)(1) of the Advisers Act to exclude investment advisers to private funds. **Senate Bill § 403 (p. 367); H.R. 4173 § 5003 (p. 1203).**

4. Limited Small Business Investment Company Adviser Exemption

The Senate Bill would add section 203(b)(7) to exempt from registration investment advisers, other than those that are Business Development Companies, who solely advise

- small business investment companies that are licensees under the Small Business Investment act of 1958 ("Small Business Companies");
- entities that have received notice from the Small Business Administration notice to proceed to qualify for a license, which notice or license has not been revoked; or
- applicants that are affiliated with one or more Small Business Companies that have applied for another license, which application remains pending.

The House Bill's exemption for advisers to Small Business Companies is nearly identical, except that the House Bill does not exclude those investment advisers that are Business Development Companies. **Senate Bill § 403 (pp. 367); H.R. 4173 § 5003 (p. 1204).**

5. Venture Capital Fund Advisers

Both bills would amend Section 203 of the Advisers Act to add section 203(l), which would exempt from registration venture capital fund advisers. The term "venture capital fund" would be defined by the SEC.

The House Bill allows the SEC to require such advisers to maintain such records and provide to the SEC such annual or other reports as the SEC deems necessary or appropriate in the public interest or for the protection of investors, whereas the Senate Bill does not. **Senate Bill § 407 (p. 376); H.R. 4173 § 5006, (pp. 1211-1212).**

6. Private Equity Fund Advisers

The Senate Bill would add Section 203(m) to the Advisers Act, which would exempt from registration and reporting any investment adviser solely advising a *private equity fund or funds*. However, within six months of the enactment of the PFIARA, the SEC would be required to issue final rules requiring private equity fund advisers to maintain such records and provide such annual or other reports as the SEC deems necessary and appropriate in the public interest and for the protection of investors. The SEC's recordkeeping rules would need to consider account fund size, governance, investment strategy, risk and other factors. The SEC would also be required to define "private equity fund" within six months of the PFIARA's enactment. **Senate Bill § 408 (pp. 376-377).**

7. Family Offices

The Senate Bill would amend Section 202(a)(11)(G) of the Advisers Act to exempt from the definition of "investment adviser" (and therefore, from registration) any family office, as that term is defined by the SEC. The SEC would be directed to define the term "family office" in a manner consistent with prior SEC exemptive orders in effect at the time of enactment of the PFIARA and to recognize the range of organizational, management and employment structures and arrangements utilized by family offices. The House Bill does not address advisers to family offices. **Senate Bill § 409 (pp. 377-378).**

B. Federal and State Jurisdiction

The Senate Bill would amend Section 203A(a)(1) of the Advisers Act to raise the AUM threshold for an investment adviser to register with the SEC from $25 million to $100 million. Accordingly, investment advisers that do not satisfy the higher AUM requirement would be required to register with the states rather than with the SEC. H.R. 4173 would increase the AUM threshold for an investment adviser to a smaller private fund to register with the SEC to $150 million. Under the House Bill, but not the Senate Bill, the SEC would be directed to require advisers to private funds, even if they do not meet the AUM threshold, to comply with recordkeeping and reporting requirements. **Senate Bill § 410 (pp. 378-379); H.R. 4173 § 5007 (pp. 1212).**

Other differences between the two bills are that (a) the Senate Bill would also provide a new exemption from registration with the SEC to a company that has elected to be a business development company pursuant to section 54 of the 1940 Act. **Senate Bill § 410 (pp. 79)**; and (b) H.R. 4173 would require the SEC to take into account the size, governance and investment strategy of mid-sized private fund advisers to determine whether they pose systemic risk when developing registration and examination procedures. **H.R. 4173 § 5007 (p. 1213).**

C. Data, Reports and Disclosures of Private Funds

The Senate and House Bills would amend the Advisers Act to add new Section 204(b), which would require registered investment adviser to maintain records and make reports to the SEC regarding private funds advised by the adviser, as mandated by the SEC based not only on the public interest and protection of investors, but also for systemic risk assessment by the

Financial Stability Oversight Council (the "FSOC"), in the case of the Senate Bill, and the Fed in the case of the House Bill.

The SEC would be required to adopt rules prescribing the types of records that advisers to private funds must make, the retention period for such records, and reports that such advisers would be required to file with the SEC. **Senate Bill § 404 (pp. 368-374); H.R. 4173 (pp. 1205-1206).**

1. Required Information

The records and reports required to be maintained or filed for each private fund advised by the investment adviser, and subject to SEC inspection, would include:

i. the amount of AUM and use of leverage;

ii. counterparty credit risk exposure;

iii. trading and investment positions;

iv. valuation policies and practices of the fund;*

v. types of assets held;*

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

vii. trading practices; and

viii. such other information as the SEC determines, in consultation with the FSOC, is necessary and appropriate in the public interest and for the protection of investors or for the assessment of systemic risk. This could result in different reporting requirements for different classes of private fund advisers based on the type or size of the fund being advise.

The House Bill generally specifies the same categories of information, except for those categories accompanied by an asterisk in the list above, and would also authorize the SEC to require the reporting of additional information. In addition, the House Bill would require registered investment advisers to provide reports and other documents and disclosures to investors, prospective investors, counterparties and creditors of any private fund advised by it. The Senate Bill does not discuss specific disclosure points. **Senate Bill § 404 (pp. 369-370); H.R. 4173 § 5004 (pp. 1205-1208).**

2. Consultation Requirements

The Senate Bill would require the SEC to consult with the FSOC, while the House version would require the SEC to consult with the Fed to determine recordkeeping and reporting requirements. The SEC would be required to make available to the FSOC (and in the House Bill, the Fed) copies of all reports, documents, records, and information filed with or provided to

the SEC by an investment adviser to a private fund, as the FOSC and/or Fed may consider necessary to assess the systemic risk of such private fund. All such reports, documents, records and information obtained from the SEC under this section would be required to be kept confidential pursuant to Section 204(b)(8). **Senate Bill § 404 (pp. 369-370);H.R. 4173 § 5004 (p. 1208).**

D. Examinations of Records and Confidentiality

Both bills would subject records of private funds maintained by their registered investment advisers to periodic, special and other examination by the SEC at any time and from time to time, as the SEC may prescribe as necessary and appropriate. The SEC would be required to make available to the FSOC (and in the House Bill, the Fed) all reports, documents, records, and information filed with or provided to the SEC by an investment adviser to a private fund for systemic risk assessment purposes.

Otherwise confidential information filed with the SEC would also be required to be provided by the SEC to (a) Congress, upon an agreement of confidentiality; (b) any other Federal department or agency or self-regulatory organization ("SRO") requesting information or reports for purposes within the scope of its jurisdiction; or (c) pursuant to a court orders in an action brought by the SEC or otherwise by the United States government. The FSOC and any department, agency or SRO that receives information or reports from the SEC would be subject to the same level of confidentiality as the SEC. In addition, all such parties would be exempt from the requirements of the Freedom of Information Act (5 USC §552) ("FOIA"), which compels federal agencies to disclose to the public any records requested in writing, unless such records are protected by an exemption under FOIA.

Any "proprietary information" of an investment adviser that the SEC ascertains from any report required to be filed with the SEC would be subject to the same limitations on public disclosure as any facts ascertained during an examination. "Proprietary information" would be defined to include sensitive, non-public information regarding an adviser's investment or trading strategies, analytical or research methodologies, trading data, compute hardware or software containing intellectual property and other information the SEC determines is proprietary. **Senate Bill § 404 (pp. 370-374); H.R. 4173 § 5004 (pp. 1207-1210).**

The current exception in Advisers Act section 201(c) regarding disclosure of the identity of clients of an investment adviser would be revised to provide that such information would also be required to be provided for purposes of assessing potential systemic risk. **Senate Bill § 405 (p. 374-75); H. R. 4173 § 5005 (p. 1211).**

E. Dual SEC-CFTC Registered Advisers

Both bills would require the SEC and the Commodity Futures Trading Commission (the "CFTC"), after consultation with the FSOC, to jointly promulgate rules to establish the form and content of reports required to be filed with the SEC and CFTC by dually-registered investment advisers and commodity pool operators. The House Bill would required the two agencies to consult with the Fed.

Both bills would amend Section 211(a) of the Advisers Act to clarify that the SEC may also make and issue rules and regulations defining technical, trade and other terms used in the Advisers Act. **Senate Bill § 406 (p. 375-76); H.R. 4173 § 5008 (p. 1215).**

F. Custody of Client Accounts

The Senate Bill would add Section 223, Custody of Client Accounts, to the Advisers Act, which would require registered investment advisers to take SEC prescribed steps to safeguard client assets over which they have custody, including but not limited to, verification of such assets by an independent public accountant. **Senate Bill § 411 (p. 379).** H.R. 4173 would not substantively change custody requirements for client accounts, but would require that records of persons with custody or use of a client's securities, deposits, or credits be subject to reasonable periodic, special or other examinations by the SEC staff. **H.R. 4173 § 7106 (p. 1289).**

G. Inflation Adjustment of the Accredited Investor Standard

The Senate Bill would increase the net worth standard for an accredited investor as defined by the SEC under the Securities Act of 1933 (the 1933 Act), to require that the individual net worth at the time of purchase of any natural person, or joint net worth with the spouse of that person, is more than $1,000,000, excluding the value of the person's primary residence. The SEC would be directed to periodically adjust the net worth standard for inflation. During the first four years following enactment of the PFIARA, the net worth standard would be set at $1,000,000. The SEC would be directed to review the definition of "accredited investor" as it applies to natural person to determine if any adjustments should be made to requirements other than the net worth standard, for investor protection in light of the economy. Beginning four years after enactment of the PFIARA, the SEC would be directed to review the definition of "accredited investor" in its entirety to determine if it should be modified to investor protection and public interest purposes and in light of the economy. **Senate Bill § 412, as amended by S.A. 4056.**

In contrast, the H.R. 4173 would require that all dollar amounts tests used by the SEC as a factor in making determinations under the Advisers Act, such as a net asset threshold, be adjusted, in intervals of ($100,000) for inflation within one year of the PFIARA's enactment and every five years thereafter. **H.R. 4173 § 5011 (pp. 1216-1217).**

H. Effective Date

The Senate Bill, as well as the House Bill, would take effect within one year of enactment, but under the Senate Bill, investment advisers would be permitted to register with the SEC under the current AUM test, rather than wait to register with the states. **Senate Bill § 416 (p. 383-84); H.R. 4173 § 5010 (p. 1216).**

I. Studies

As discussed below, the PFIARA requires several types of studies to be conducted. The results of all such studies would be reported to the Senate Committee on Banking, Housing, and Urban Affairs (the "Senate Banking Committee") and the House Committee on Financial

Services (the "House Financial Services Committee") within one or two years of enactment of the PFIARA.

In contrast, the House Bill would require the Comptroller General of the United States (the "Comptroller") to carry out a study to assess the annual costs of the registration and ongoing reporting requirements on industry members and their investors. **H.R. 4173 § 5009 (pp. 1215-1216).**

1. Accredited Investors

The Comptroller would be required to conduct a study on the appropriate criteria for determining financial thresholds or other criteria needed to qualify for accredited investor status and eligibility to invest in private funds. The report would be due within one year of enactment of the PFIARA. **Senate Bill § 413 (p. 382).**

2. SRO for Private Funds

The Comptroller would conduct a study on the feasibility of forming an SRO to oversee private funds. The report would be due within one year of enactment of the PFIARA. **Senate Bill § 414 (pp. 382-383).**

3. Short Selling

The SEC's Office of Risk, Strategy and Financial Innovation would be required to conduct a study on the state of short selling on national securities exchanges and in over-the-counter markets. The report, together with any recommendations for market improvements, would be due within two years of enactment of the PFIARA. **Senate Bill § 415 (p. 383).**

By contrast, the House Bill would make substantive changes to short selling regulation. First, it would amend section 13(f) of the Exchange Act to require institutional investment managers that effect short sales to file daily reports with the SEC including the names of the institution and the investment manager; the title, class and CUSIP numbers of the relevant securities; the number of shares or principal amount; the aggregate fair market value of each security; and any additional information required by the SEC. This information would be subject to the non-disclosure and confidential protections of the Advisers Act. Second, the SEC would be required to adopt rules requiring at least monthly public disclosure of the aggregate amount of the number of short sales of each security during the relevant reporting period, and any additional information determined by the SEC. Third, new Exchange Act section 9(d) would specifically provide that it is illegal for any person, directly or indirectly, to effect, alone or with one more other persons, a manipulative short sale of any security. The SEC would be required to issue other rules as necessary or appropriate to ensure that the appropriate enforcement options and remedies are available. Fourth, new Exchange Act section 15(e) would require broker-dealers to provide notice to their customers that they may elect not to allow their fully paid securities to be used in connection with short sales, and to provide disclosure to customers' whose securities they use of any compensation they receive for lending the securities. **H.R. 4173 § 7422 (pp. 1383-1386).**

TITLE V — INSURANCE

Under Title V, the "Office of National Insurance Act of 2010," the newly established Office of National Insurance would be primarily an information collection and monitoring agency, with some authority in the realm of international insurance agreements. The Senate Bill provisions largely mirror those governing the Federal Insurance Office proposed under H.R. 4173. The language of the bill makes clear that the Office of National Insurance has no general supervisory or regulatory authority over the business of insurance. It preserves the primary role of states in regulating insurance, in so far as the Office of National Insurance is barred from preempting state insurance laws governing rates, premiums, coverage requirements, antitrust laws, underwriting, or sales practices. That said, the Senate Bill does direct the Office of National Insurance to conduct a study that considers the potential risks and benefits of a Federal system of insurance regulation.

A. Establishment of Office of National Insurance

The Office of National Insurance (hereinafter "the Office") would be an office within the Department of the Treasury. The Office would be headed by a Director, to be appointed by the Secretary of the Treasury. **Senate Bill § 502 (pp. 384-385).**

1. Functions of the Office

The scope of the Office's authority would extend to all lines of insurance except health insurance. Among other things, the Office would have the authority to:

- Monitor all aspects of the insurance industry, identifying issues or gaps in regulation that could contribute to systemic crisis in the insurance industry;
- Recommend to the Financial Stability Oversight Council that it designate an insurer (and its affiliates) as an entity subject to the Fed's supervision under Title I;
- Coordinate Federal efforts and develop Federal policy on the prudential aspects of international insurance matters;
- Determine whether state insurance measures are preempted by International Insurance Agreements on Prudential Measures;[6]

[6] "International Insurance Agreements on Prudential Matters" refers to a written bilateral or multilateral agreement entered into between the United States and a foreign government, authority, or regulatory entity regarding prudential measurers applicable to the business of insurance or reinsurance. The Secretary of the Treasury is authorized to negotiate and enter into International Insurance Agreements on Prudential Measurers on behalf of the United States.

- Consult with states and state insurance regulators regarding insurance matters of national and international importance; and

- Advise the Secretary of the Treasury on major domestic and prudential international insurance policy issues. **Senate Bill § 502 (pp. 385-386).**

2. Collection of Information From Insurers

In order to carry out these functions, the Office would be authorized to receive and collect data and information from the insurance industry and insurers. Before collecting any such data or information, the Office would need to coordinate with each relevant State insurance regulator (or other relevant Federal or State regulatory agency in the case of an affiliate of an insurer) to determine if the information can be obtained from the regulator or another publicly available source. The Director could, upon a written finding, require by subpoena an insurer to produce data or information necessary for the Office to carry out its functions. The Office, however, could not require a small insurer to submit such data or information, with the threshold for the minimum size for such exemption to be established by the Office. **Senate Bill § 502 (pp. 387-391).**

3. Preemption of State Insurance Measures

With regard to preemption of state insurance measures, the Senate Bill prescribes that a state insurance measure would be preempted only to the extent that such measure (1) results in less favorable treatment of a non-United States insurer domiciled in a foreign jurisdiction that is subject to an international prudential insurance agreement than a United States insurer and (2) is inconsistent with an International Insurance Agreement on Prudential Matters. Before making a determination regarding such preemption, the Director would need to comply with Title V's notice requirements. The language of Title V clarifies that the Office would not have authority to preempt any state insurance measure governing rates, premiums, underwriting, sales practices, coverage requirements, or state antitrust laws applicable to insurance. Further, nothing in this section would preempt any state insurance measure governing the capital or solvency of an insurer except to the extent that such state insurance measure directly results in less favorable treatment of a non-United States insurer. **Senate Bill § 502 (pp. 391-393).**

4. Annual Reports

The Senate Bill provides that, beginning on September 30, 2011, the Director would be required to submit an annual report to the President, the Senate Banking Committee, and the House Financial Services Committee, which describes the insurance industry, any actions taken by the Office regarding the preemption of state insurance measures, and any other information deemed relevant or requested by the Committees. **Senate Bill § 502 (pp. 395).**

5. Study and Report on Regulation of Insurance

Finally, no later than 18 months after Title V is enacted, the Director would need to conduct a study and submit a report to Congress on how to modernize and improve the system of insurance regulation in the United States. This study and report would be guided by considerations of systemic risk regulation, capital standards, consumer protection, the degree of

national uniformity of state insurance regulation, the regulation of insurance companies and affiliates on a consolidated basis, and international coordination of insurance regulation. The Senate Bill also enumerates additional factors that the study should examine including the costs, benefits, feasibility, and effects of potential Federal regulation of insurance, as well as the potential consequences of subjecting insurance companies to a Federal resolution authority. **Senate Bill § 502 (pp. 396-399).**

6. International Insurance Agreements on Prudential Measurers

Under the Senate Bill, the Secretary of the Treasury would be authorized to negotiate and enter into International Insurance Agreements on Prudential Measures on behalf of the United States. In doing so, the Secretary would be required to consult with the United States Trade Representative. The Bill also clarifies, however, that this section (as well as the one preceding it) cannot not be construed to affect the development and coordination of United States international trade policy or the administration of the Untied States trade agreements program. **Senate Bill § 502 (p. 401).**

B. State-Based Insurance Reforms

Title V provides for state-based reforms that seek to streamline the regulation of surplus lines of insurance and reinsurance. In particular, the Senate Bill seeks to assert the primary regulatory authority of an insured's home state with regard to surplus lines and the insurer's domiciliary state with respect to reinsurance. These reforms would take effect one year after the subtitle in enacted. **Senate Bill § 512 (p. 402).**

1. Nonadmitted Insurance[7]

Under Subtitle B of Title V, no state other than the home state[8] of an insured could require any premium tax payment of nonadmitted insurance. States could enter into a compact to allocate among themselves the premium taxes paid to an insured's home state and, according to the Bill, Congress intends that each state adopt nationwide uniform requirements, forms, and procedures that provide for the reporting, payment, collection, and allocation of such taxes. **Senate Bill §§ 521(a-b) (pp. 403-405).**

Additionally, the placement of nonadmitted insurance would be subject to the statutory and regulatory requirements of the insured's home state only. Thus, the home state (and not any

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[7] The term "nonadmitted insurance" refers to a policy purchased by an insured from an insurer in another state. This insurer is not licensed in the state where the insured's risk is located.

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

other state) could require a surplus lines broker to be licensed in order to sell, solicit, or negotiate such nonadmitted insurance. **Senate Bill § 522 (pp. 405-406).**

The Senate Bill also provides for uniform standards for surplus lines eligibility among states, as well as streamlined applications for surplus lines brokers who seek to procure nonadmitted insurance for commercial purchasers. **Senate Bill §§ 524 and 525 (pp. 406-408).**

Finally, the Senate Bill directs the Comptroller General to conduct a study of the nonadmitted insurance market to determine the effect of these regulations on the size and market share of the nonadmitted insurance market for providing coverage typically provided by the admitted insurance market. **Senate Bill § 526 (pp. 408-409).**

2. Reinsurance

With regard to reinsurance, Title V establishes regulations pertaining to credits for reinsurance and the preemption of certain state laws as it applies to a ceding insurer.[9] Namely, the Bill provides that if the domiciliary state[10] of a ceding insurer is an National Association of Insurance Commissioners (NAIC)-accredited state and it recognizes credit for reinsurance for the insurer's ceded risk, then other states would not be permitted to deny such credit. **Senate Bill § 531(a) (p. 418).** Further, all laws, regulations, provisions, or other actions of a state that is not the domiciliary of the ceding insurer (except those with respect to taxes and assessments) would be preempted to the extent that they restrict the rights of the ceding insurer to resolve disputes pursuant to contractual arbitration or otherwise apply the state's laws to reinsurance agreements of ceding insurers not domiciled in that state. **Senate Bill § 531(b) (pp. 418-419).**

Finally, the Senate Bill seeks to limit the regulation of a reinsurer's financial solvency to its domiciliary state, so long as such that state is NAIC-accredited or has similar financial solvency requirements. If this is the case, no other state could require the reinsurer to provide any additional financial information other than that required by the domiciliary state. **Senate Bill § 532 (pp. 419-420).**

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[9] A "ceding insurer", in the context of reinsurance, is the original or primary insurer, in other words, the insurance company which purchases reinsurance.

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

TITLE VI — ENHANCED REGULATION OF DEPOSITORY INSTITUTION HOLDING COMPANIES

Title VI, the "Bank and Savings Association Holding Company and Depository Institution Regulatory Improvement Act of 2010," sets out significant enhancements to the regulation of depository institutions and their holding companies.

The Title would make meaningful changes in the laws regulating banks, thrifts and their holding companies, including placing a three-year moratorium on the ability of a "commercial firm" to take control of any new credit card banks, industrial loan companies or trust banks. It also includes an expansive version of the much discussed "Volcker Rule," based on proposals made by former Fed Chairman Paul Volcker. Provisions constituting the Volcker Rule include restrictions on capital markets activity by banks and bank holding companies, restrictions on proprietary trading and limitations on relationships with hedge funds and private equity funds. Title VI would also add or amend a number of other provisions, including:

- requirements concerning examinations;
- a requirement that financial holding companies remain well capitalized and well managed;
- a source of strength requirement;
- a provision relating to interstate acquisitions;
- provisions relating to affiliate transactions;
- lending limits applicable to credit exposure on derivative transactions, repurchase agreements, reverse repurchase agreements and securities lending and borrowing transactions;
- *de novo* branching;
- insider transactions;
- securities holding companies; and
- concentration limits.

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

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

The Bill establishes a three-year moratorium during which "commercial firms" cannot establish new or acquiring existing credit card banks, industrial banks or trust banks.[11] **Senate Bill § 603(a) (pp. 423-424).** Note that, under § 602, a "commercial firm" is defined as any entity that derives at least 15% of its consolidated gross revenue from activities that are not financial in nature. **Senate Bill § 602 (p. 422).** The FDIC would be barred from approving an application for deposit insurance for a industrial bank, a credit card bank, or a trust bank that is directly or indirectly owned or controlled by a commercial firm if the application was received after November 10, 2009. Federal banking agencies would be required to disapprove any change of control (under section 7(j) of the FDI Act) over an industrial bank, credit card bank or trust bank if the change would result in direct or indirect control of the bank shifting to a commercial firm. **Senate Bill § 603(a) (pp. 423-424).** Note that the Bill is silent with respect to merger acquisitions and does not appear to limit a merger in which the resulting institution is an institution that was previously controlled by a commercial firm.

The Senate Bill provides two limited exceptions to the prohibition on a commercial firm gaining control of a credit card bank, industrial bank or trust bank. It allows a commercial firm to acquire a credit card bank, industrial bank or trust bank when the bank is either in danger of default (as determined by the appropriate Federal banking agency) or the change of control results from the merger or whole acquisition of a commercial firm that already (directly or indirectly) controls the bank by a second commercial firm, so that the bank was owned by a commercial firm both before and after the transaction. **Senate Bill § 603(a)(3)(B) (p. 421); H.R. 4173 § 1301(a)(4) (pp. 229-231)** (amending BHC Act § 2(c)(2)(H) to generally end the industrial loans company and trust bank exceptions).

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

During this three year moratorium discussed above, the Government Accountability Office ("GAO") is required to conduct a study of whether commercial companies should be permitted to own credit card banks, industrial banks and trust banks. Specifically, the GAO would be required to study whether it is necessary to eliminate these exceptions to the bank holding company definition in BHC Act §§ 2(a) and 2(c). Under the terms of the Senate Bill, the study would not address the implications of such a change for a company that already controls

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[11] The Senate Bill defines each of "credit card bank", "industrial bank" and "trust bank" by reference to the Bank Holding Company Act, specifically BHC Act §§ 2(c)(2)(D), (F) and (H). **Senate Bill §§ 603(a)(1)(A), (B) and (C) (pp. 422-423).**

such institutions. If these exceptions were eliminated, then all future acquisitions of such institutions by a commercial firm would be barred and the ability of existing commercial firms to control such banking institutions would be subject to termination (unless grandfathered). The GAO study would identify the types and number of institutions excepted from BHC Act § 2, determine the adequacy of the Federal bank regulatory framework applicable to these institutions, and evaluate the potential consequences of subjecting these banks to the BHC Act. **Senate Bill § 603(b)(2)(A) (pp. 425-427).**

The study also would address eliminating the BHC Act exception for savings associations, which excludes companies controlling a savings association from being regulated as bank holding companies. See BHC Act § 2(c)(2)(B). In addition, the GAO study would make specific determinations with regard to the adequacy of the Federal bank regulatory framework and the potential consequences of subjecting S&L holding companies to the BHC Act, including with respect to the availability and allocation of credit, economic stability and safety and soundness of such institutions. **Senate Bill § 603(b)(2)(B) (pp. 427-428).**

The Senate Bill would require that the Comptroller General submit the report of the GAO study to the Senate Banking Committee and the House Financial Services Committee within 18 months after the legislation is enacted. **Senate Bill § 603(b)(3) (p. 428).** This schedule would provide Congress 18 months to enact legislation before the end of the moratorium.

B. Reports and Examinations of Holding Companies

1. Reports

The Senate Bill would amend the BHC Act to extend the existing requirement that regulators rely on information provided in externally audited financial statements and publicly available information to the OCC, FDIC and Fed as supervisors of bank holding companies. **Senate Bill § 604(a)(1) (p. 429).** In addition, the Bill adds new BHC Act § 5(c)(1)(C), extending the existing requirement that any bank holding company (or subsidiary) promptly provide any of the information described in BHC Act § 5(c)(1)(B) to any "appropriate Federal banking agency," rather than, currently, the Fed. **Senate Bill § 604(a)(2)**; **H.R. 4173 § 1303(a) (pp. 265-266).**

2. Examinations

The Senate Bill would amend BHC Act § 5(c)(2) to provide that the appropriate Federal banking agency for a bank holding company is authorized to conduct examinations of the bank holding company (and each of its subsidiaries) in order to determine the nature of the companies' operations and financial conditions as well as to assess risks within the bank holding company that may pose a threat to the safety and soundness of the holding company's depository institution subsidiaries or the stability of the United States financial system. **Senate Bill § 604(b) (pp. 430-432).** In doing so, the appropriate Federal banking agency for either a savings and loan holding company or for a bank holding company is directed to "the fullest extent possible" to rely on reports the company has had to file with regulators or examination reports that were made by other Federal or State agencies relating the bank holding company (and its

subsidiaries), to use externally audited financial statements, and to coordinate with those other regulators. **Senate Bill § 604(b) (pp. 430-432).**

The Bill amends HOLA § 2 to reflect the transfer of OTS authority, granting the appropriate Federal banking agency for a savings and loan holding company authority to conduct examinations of functionally regulated subsidiaries. **Senate Bill § 604(g) (pp. 435-436).** The Bill strikes existing HOLA § 10(b)(4) relating to examinations. This paragraph currently provides that each savings and loan holding company (and each of its subsidiaries) is subject to examination, the cost of which is to be paid by the holding company, with the Director obligated to use reports filed with or examinations made by other Federal or State supervisory authorities to the extent feasible. The amendment would substitute the appropriate Federal banking agency for the OTS and list the purposes of such examinations, specifically: to inform regulators of the nature of the operations and financial condition of the holding company and its subsidiaries, to inform regulators of the financial, operational and other risk within the holding company that may pose a risk to safety and soundness or financial stability, and to inform regulators about the systems the holding company uses to monitor risk, as well as to enforce compliance with Federal law. **Senate Bill § 604(g) (pp. 435-436).**

The new HOLA § 10(b) would preserve the current requirement to use reports made by other Federal and State agencies "to the fullest extent possible" (rather than the current "to the extent deemed feasible") and would require that the appropriate Federal banking agency coordinate with other regulators with regard to providing reasonable notice before requesting a report and avoiding duplicative examinations. **Senate Bill § 604(g) (pp. 435-436).**

C. Increased Fed Authority Over Functionally Regulated Subsidiaries of Bank Holding Companies

The Senate Bill amends BHC Act § 5(c)(3) to eliminate current prohibitions on the Fed imposing capital requirements on functionally regulated subsidiaries of a bank holding companies. It also strikes Section 5(c)(4) which generally calls for the Fed to defer to the functional regulators of securities and insurance activities. **Senate Bill § 604(c) (pp. 432-433).**

The Bill strikes BHC Act § 10A, as does Section 1303(e) of H.R. 4173 (p. 269). The GLB Act established BHC Act § 10A, under which the Fed generally may not "prescribe regulations, issue or seek entry of orders, impose restraints, restrictions, guidelines, requirements, safeguards, or standards, or otherwise take action under or pursuant to any provision of [the BHC Act] or Section 8 of the [FDI Act] against or with respect to" a functionally regulated subsidiary. **BHC Act § 10A(a).** Thus, the Fed is currently prohibited from issuing regulations or guidance that specifies policies for subsidiaries engaging in regulated activities. At the same time, § 10A provides two potentially significant exceptions to these prohibitions:

> (1) <u>the material risk exception</u>, under which the Fed may take supervisory action that "is necessary to prevent or redress an unsafe or unsound practice or breach of fiduciary duty" that poses a material risk to the financial safety, soundness or stability of an affiliated depository institution; or the domestic or international payment system, **see BHC Act § 10A(a)**; and

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

Striking BHC Act § 10A enhances Fed authority but does not supplant the functional regulators. The Senate Bill (like H.R. 4173) would continue limits on the Fed's power with respect to functionally regulated subsidiaries and preserve the role of the agencies primarily responsible for regulating them. Under the Senate Bill, the appropriate Federal banking agency would be required to provide notice to and consult with the appropriate Federal banking agency or State regulatory agency of a functionally regulated subsidiary before requesting a report or commencing an examination of the subsidiary. **Senate Bill § 604(b) (pp. 430-432).** In addition, Senate Bill § 162(b) (like H.R. 4173 § 1104(b)(1)) provides that if the Fed finds a condition, practice, or activity of a functionally regulated subsidiary does not comply with the Fed's regulations or orders, the Fed may recommend that the primary financial regulatory agency for the subsidiary initiate a supervisory action or enforcement proceeding. **Senate Bill § 162(b) (pp. 89-90).** The Senate Bill provides that if during the 60 days following the date the primary financial regulatory agency receives a recommendation it does not take supervisory or enforcement action against the subsidiary that is "acceptable" to the Fed, the Fed may take the recommended supervisory or enforcement action "as if the subsidiary were a bank holding company subject to supervision by the Board of Governors". **Senate Bill § 162(b)(2) (p. 90).**

Under H.R. 4173 the Fed can recommend that the Federal financial regulatory agency prescribe prudential standards for a functionally regulated subsidiary, which standards must be of the same types as the standards imposed by the Fed. **H.R. 4173 § 1104(b)(1) (pp. 64-65).**

D. Acquisitions of Banks and Nonbanks under the BHC Act

1. Acquisitions of Banks

The Senate Bill amends BHC Act § 3(c) to require consideration of whether a proposed acquisition, merger, or consolidation between banks (or a bank and a nonbank) would result in greater or more concentrated risks to the stability of the United States banking or financial system. **Senate Bill § 604(d) (p. 433)**; **H.R. 4173 § 1313(a) (pp. 279-280).**

The Senate Bill also provides that, for purposes of BHC Act § 3, a nonbank financial company supervised by the Fed is deemed to be, and is treated as, a bank holding company. **Senate Bill § 163(a) (p. 90).**

2. Acquisitions of Nonbanks

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

The Senate Bill amends BHC Act § 4(j)(2)(A), to require that the Fed consider as negative the "risk to the stability of the United States banking or financial system" as a consequences of a transaction or engaging in an activity. The existing criteria are undue concentration of resources, decreased or unfair competition, conflicts of interest and unsound banking practices. **Senate Bill § 604(e)(1) (p. 433); H.R. 4173 § 1313(b) (pp. 280-281)** (amending BHC Act § 4(j)(2)(A)).

The Bill would amend BHC Act § 4(k)(6)(B) to require that a financial holding company receive prior approval to acquire a company with total consolidated assets above $25 billion. **Senate Bill § 604(e)(2) (pp. 433-434).** For smaller acquisitions, present law would not change, allowing a financial holding company to engage in activities that are financial in nature and acquire shares in financial companies that engage in financial activities without Fed approval.

In addition, the Senate Bill would require prior notice of large acquisitions to the Fed. A bank holding company with total consolidated assets of $50 billion or more or a nonbank financial company supervised by the Fed would need to provide written notice to the Fed before gaining direct or indirect control over a company engaged in BHC Act § 4(k) financial activities with total consolidated assets of $10 billion or more. **Senate Bill § 163(b) (pp. 90-92).**

E. Oversight of Depository Institutions' and Their Subsidiaries' Activities

The Senate Bill proposes to insert new BHC Act § 6, entitled "Assuring Consistent Oversight of Permissible Activities of Depository Institution Subsidiaries of Holding Companies." Under this new section, the "lead Federal banking agency" for each depository institution holding company would be required to conduct examinations of the activities of the holding companies and their subsidiaries in order to determine whether the activities present safety and soundness risks, are conducted in accordance with applicable law, and are subject to appropriate systems for monitoring and controlling financial risks. **Senate Bill § 605 (pp. 440-445).**

New BHC § 6 would define the term "lead Federal banking agency" to mean either the Office of the Comptroller or the FDIC. The lead Federal banking agency would be the Comptroller in the case of a depository institution holding company having either only subsidiaries that are Federal depository institutions or where the total consolidated assets of all subsidiaries that are Federal depository institutions exceeds the total consolidated assets of those subsidiaries that are State depository institutions. However, the lead Federal banking agency would be the FDIC in the case of a depository institution holding company having either only subsidiaries that are State depository institutions or where the total consolidated assets of all subsidiaries that are State depository institutions exceeds the total consolidated assets of all that are Federal depository institutions. **Senate Bill § 605.** The Senate Bill provides guidance for calculating "total consolidated assets," referring to FDI Act § 3(q). **Senate Bill § 605 (pp. 440-445).**

Specifically, the "lead Federal banking agency" would be required to examine the activities of each depository institution subsidiary – except for functionally regulated subsidiaries – of the depository institution holding company to determine whether the activities (i) present

safety and soundness risks to the depository institution subsidiary or the holding company, (ii) are conducted according to law, and (iii) are subject to appropriate risk monitoring systems. **Senate Bill § 605.** The Senate Bill sets out the process for conducting examinations and would require that for each depository institution holding company for which the Fed is the "appropriate Federal banking agency" the "lead Federal banking agency" must coordinate supervision activities so as to avoid duplication, share information and ensure the holding company and subsidiaries are not subject to conflicting supervisory demands. **Senate Bill § 605 (pp. 440-445).**

F. Recommendation and Back-Up Authority

Based on the information collected in such examinations, the banking agency could submit a recommendation to the Fed that it take enforcement action against a nondepository subsidiary of the depository institution where appropriate. If the Fed does not take such recommended enforcement action or provide a plan for enforcement action that is acceptable to the lead Federal banking agency within sixty days of receipt of the recommendation, the lead Federal banking agency could then take such action as if the subsidiary were an insured depository. **Senate Bill § 605 (pp. 440-445).**

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

The Senate Bill would amend BHC Act § 4(l)(1), to require a bank holding company engaging in any section 4(k) financial activity to be well capitalized and well managed —in addition to the present requirement that the banks in a financial holding company be well-capitalized and well-managed. **Senate Bill § 606 (pp. 445-446)**; **H.R. 4173 § 1304 (pp. 269-270)** (similarly amending BHC Act § 4(l)(1)). Thus, the amendment would extend the well capitalized and well managed requirement from the depository subsidiary to the bank holding company level.

H. Enhancing Restrictions on Bank Transitions with Affiliates – Securities Lending and Derivatives Transactions

The Senate Bill would enhance existing restrictions on bank transactions with affiliates by amending Federal Reserve Act § 23A(b) to include securities lending and derivative transactions. First, the term "affiliate" would be redefined to broadly include "any investment funds with respect to which a member bank or affiliate thereof is an investment advisor," replacing a more complex provision that currently includes as an affiliate any company that is sponsored or advised on a contractual basis by a member bank or that is an investment company for which a member bank is an investment advisor as defined in the Investment Company Act. Affiliates would be considered an "investment fund" (e.g., a hedge or private equity fund) even if organized and managed outside the Investment Company and Investment Advisers Act. **Senate Bill § 608 (pp. 446-455).** Significantly, securities lending transactions would be added to the "covered transactions" definition, as are derivative transactions to the extent either type of transaction "causes a member bank or a subsidiary to have credit exposure to the affiliate." It also would make a technical amendment to the definition of "covered transactions" in which the reference to repurchase agreements – defined as "a purchase of assets subject to an agreement to

repurchase" – is moved from its current position in a provision relating to the purchase of assets to a provision relating to loans and extensions of credit. **Senate Bill § 608 (pp. 446-455).**

The Senate Bill makes several additional changes, which would expand the definition of "covered transactions". The Bill would expand the § 23A(c)(1)collateral requirements to include "any credit exposure of a member bank or a subsidiary to an affiliate resulting from a securities borrowing or lending transaction or a derivative transaction . . . ." Also, the Bill would expand the § 23A(c)(1) references to "a letter of credit" to include "letter of credit, or credit exposure" in each case. **Senate Bill § 608 (pp. 446-455).** Consistent with the expansion of the "covered transaction" definition, the Bill would amend § 23A(d)(4) dealing with exceptions to the affiliate transactions rule to add that the section does not apply to "having credit exposure resulting from a securities borrowing or lending transaction, or derivative transaction to" an affiliate that is fully secured by either obligations of the United States, that are guaranteed by the United States or a segregated, earmarked deposit account with the member bank. **Senate Bill § 608 (pp. 446-455).**

Further changes are related to the "covered transaction" definition. The Bill would, for example, strike § 23A(c)(2), currently providing that any collateral subsequently retired or amortized must be replaced by additional collateral where needed to keep the ratio of collateral to outstanding loan value at a minimum level. The Bill also amends § 23A(c)(3) (redesignated as paragraph 2) to add that a low quality asset is not acceptable as collateral for, in addition to existing classes of transactions, credit exposure to an affiliate resulting from a securities borrowing or lending transaction. **Senate Bill § 608 (pp. 446-455).**

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

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

- Any exemption would be required to be found by to the Board to be in the public interest and consistent with the purposes of the affiliate transactions rules (as it must under current law), as at present. The Bill would add the requirement that the Chairperson of the FDIC would need to receive notice of the Fed's finding that the exception was in the public interest and "not object, in writing" to the finding within 60 days of receiving notice. **Senate Bill § 608 (pp. 446-455).**

Exemptions would no longer be the sole province of the Board; rather, the OCC and the FDIC would have a parallel role with the Board. Specifically, the Comptroller of the Currency would have the power to exempt a transaction of a national bank from the affiliate transaction rules if the Fed and the Comptroller jointly find the exemption is in the public interest and notify the Chairperson of the FDIC and also the Chairperson of the FDIC does not object in writing to the exemption within 60 days of receiving notice of the proposed exemption. **Senate Bill § 608 (pp. 446-455).** Also, the FDIC would have the authority to exempt transactions of a State bank if the Fed and the FDIC jointly find the exemption is in the public interest and the Chairperson of the FDIC finds the exemption does not present an unacceptable risk to the Deposit Insurance Fund. **Senate Bill § 608 (pp. 446-455).**

The Senate Bill would amend Federal Reserve Act § 23B(e), relating to restrictions on transactions with affiliates and the power of the Fed to issue regulations exempting transactions or relationships from the section. Parallel to the § 23A exemptions, the Fed would be required to find any exemption or exclusion to be in the public interest and consistent with the section, and also notify the Chairperson of the FDIC and the Chairperson must not object in writing within 60 days of receiving notice. **Senate Bill § 608 (pp. 446-455).**

The Senate Bill also would amend HOLA § 11 to add that the Comptroller could exempt transactions of a Federal savings association if the Fed and the Comptroller jointly find the exemption is in the public interest and the Chairperson of the FDIC does not object to the exemption within a 60 day notice period. Similarly, the Bill provides that the FDIC could exempt a State savings association from the requirements of the section if the Fed and the FDIC jointly find the exemption is in the public interest and the exemption does not present an unacceptable risk to the Deposit Insurance Fund. **Senate Bill § 608 (pp. 446-455).**

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

Senate Bill § 609 would strike Federal Reserve Act § 23A(e)(3) to end the exception for transactions between a bank and a financial subsidiary. **Senate Bill § 609 (pp. 455-456).** Under the current Federal Reserve Act, the restrictions regarding transactions with affiliates do not apply to covered transactions between a bank and any individual financial subsidiary of the bank. **See, also, H.R. 4173 § 1307 (pp. 273-274).**

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

The Senate Bill would amend current law controlling loans by member banks to their executive officers, directors, and principal shareholders by specifying that the term "loans and extensions of credit" includes all direct or indirect advances of funds to a person made on the basis of any obligation of that person to repay the funds, any liability of a national banking association to advance funds to or on behalf of a person pursuant to a contractual commitment, and credit exposure to a person arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction or securities borrowing transaction between the national banking association and the person. The Senate Bill defines the term "derivative transaction" to include "any transaction that is a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets". **Senate Bill § 610 (pp. 456-458); H.R. 4173 § 1308 (pp. 274-276).** Both the Senate and House bills achieve this by amending Section 5200 of the Revised Statutes of the United States (12 U.S.C. § **84**). Additionally, the Senate Bill would amend FDI Act § 18 to apply these lending limits to insured State banks in the same manner and to the same extent as if they were national banking associations. **Senate Bill § 611 (p. 458); H.R. 4173 § 1311 (pp. 278-279).**

The Senate Bill would also amend the Federal Reserve Act § 22(h)(9)(D) dealing with extensions of credit to executive officers, directors, and principal shareholders of member banks by expanding the scope of "extension of credit" to include cases where the member bank has credit exposure to a person arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction or securities borrowing transaction. **Senate Bill § 614 (pp. 461-462); H.R. 4173 § 1308 (pp. 277-278).**

In addition, the Senate Bill would amend FDI Act § 18 by inserting a new subsection that would prohibit an insured depository institution from purchasing an asset from or selling an asset to one of its executive officers, directors, or principal shareholders (or any related interest of such person) unless: (1) the transaction is on market terms and (2) the transaction is approved by the majority of the institution's uninterested directors, if the transaction comprises of more than 10% of the institution's capital stock and surplus. The amendment would also empower the Fed to issue rules needed to define terms and carry out the new subsection. **Senate Bill § 615 (pp. 462-463).**

K. Conversions of Troubled Banks and Savings Associations

The Senate Bill would prohibit conversions of national banks to State banks and State banks to national banks at any time when the banks are subject to enforcement orders including a cease and desist order. This would be accomplished in two ways: first, by amending 12 U.S.C. § 214 et seq. relating to the conversion of national banks to a State bank by inserting a new section that would prohibit conversions to a State bank or State savings association if a national bank is subject to a cease and desist order or other formal enforcement order and, second, by amending 12 U.S.C. § 35 relating to the conversion of a State bank to a national bank by prohibiting the Comptroller from approving the conversion when the State bank is subject to a cease and desist order or other enforcement order. **Senate Bill §§ 612(a) and (b) (pp. 458-459); H.R. 4173 § 1309 (pp. 276-277)** (amending 12 U.S.C. § 215 et. seq. and 12 U.S. C. § 35). Similarly, the Bill would amend HOLA § 5(i) to provide that a Federal savings association can not convert to a national bank or State bank or State savings association if it is subject to a cease and desist order or other formal enforcement order. **Senate Bill § 612(c)(pp. 459-460); H.R. 4173 § 1309 (pp. 276-277)** (amending HOLA **§** 5(i)

L. Source of Strength Requirements

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

The Senate Bill would add a "source of strength" requirement to the FDI Act as new Section 38A.This section would require that a bank holding company or savings and loan

holding company serve as a source of financial strength for its depository institution subsidiary. "Source of financial strength" is defined to mean "the ability of a company that directly or indirectly controls an insured depository institution to provide financial assistance to such insured depository institution in the event of the financial distress of the insured depository institution." Any other company that controls an insured depository institution but is not a bank holding company or savings and loan holding company, would be required to serve as a source of financial strength for it. Such "other companies" could also be required to submit reports on their ability to serve as a source of strength. The Federal banking agencies would jointly issue final rules within one year of passage to carry out this new section. **Senate Bill § 616 (pp. 463-465).**

Note that under the House Bill, H.R. 4173, new BHC Act § 6(f) would provide that any company that "directly or indirectly" controls an intermediate "Section 6" holding company would be required to serve as a source of financial strength to its Section 6 holding company subsidiary. **H.R. 4173 § 1301(c) (p. 264).**

M. Elimination of Elective Investment Bank Holding Company Framework

Both the Senate and House bills would eliminate the elective investment banking holding company framework, which allows the SEC to serve as a "holding company" regulator for such as companies as Bear Sterns and Lehman Brothers. Securities Exchange Act § 17(i) currently provides for the elective supervision of an investment bank holding company that does not have a bank or savings association affiliate. This provision would allow an investment bank holding company that is not an affiliate of an insured bank to become supervised as an investment bank holding company by filing a notice of intention with the SEC. Under the Senate Bill, Securities Exchange Act § 17 would be amended by striking subsection (i), thus eliminating the elective investment bank holding company framework. **Senate Bill § 617 (p. 466)**; **H.R. 4173 § 1314 (pp. 282-283).**

N. Securities Holding Companies

The Senate Bill provides for the recognition of supervised "securities holding companies." Under the supervision of the Board, these companies would be subject to regulation under FDI Act § 8(b), (c) through (s), and (u) and under the BHC Act to the same extent as if they were bank holding companies, except that they are not deemed bank holding companies for purposes of BHC Act § 4. **Senate Bill § 618(e) (p. 475).** The Bill defines "securities holding company" to mean an entity that owns or controls one or more registered broker dealers but excludes a nonbank financial company supervised by the Fed, an affiliate of an insured bank, and supervised foreign banks. **Senate Bill § 618(a) (pp. 466-468).** The Bill provides that a securities holding company subject to comprehensive consolidated supervision under foreign law can register with the Fed to become a supervised securities holding company. The Bill also provides that all supervised securities holding companies (and each affiliate) must make and maintain records the Fed determines are needed to monitor compliance. Records required to be kept include balance sheet or income statements, assessments of consolidated capital and liquidity, a report by an independent auditor attesting to compliance, and a report concerning the extent the company has complied with regulations and orders. **Senate Bill §§ 618(b) and (c)**

(pp. 468-469). The Senate Bill also grants the Fed examination authority over any supervised securities holding company and any affiliate, but requires the Fed to use reports and examinations made by other Federal and State regulators to the fullest extent possible. **Senate Bill § 618(c)(3) (p. 472).** The Fed would have authority to prescribe capital adequacy and other risk management standards for supervised securities holding companies, which could be differentiated on an individual basis or by category. **Senate Bill § 618(d)**.

O. Restrictions on Proprietary Trading by Banks and Bank Holding Companies – the "Volcker Rule"

The Senate Bill includes proposals made by former Fed Chairman Paul Volcker relating to restrictions on proprietary trading and hedge fund activity by banks and bank holding companies. The Bill would require that Federal banking agencies jointly prohibit proprietary trading and investment in or sponsorship of hedge funds and private equity funds[12] by an insured depository institution, a company that controls an insured depository institution or is treated as a bank holding company for purposes of the BHC Act, and any subsidiary of such company, subject to the recommendations and modifications of the Council. The Bill defines the terms "hedge fund", "proprietary trading", and "sponsoring" in broad terms. The Bill defines the terms "hedge fund" and "private equity fund" to be synonymous and to mean "a company or other entity that is exempt from registration as an investment company" under Investment Company Act **§§** 3(c)(1) or (7). **Senate Bill § 619(a)(1) (p. 476).** These restrictions would not go into effect until a study is conducted and implementing rules are adopted under Senate Bill § 619(g).

Such prohibitions would not apply to investments in obligations of the United States or obligations and instruments of various agencies and associations, such as the Federal Home Loan Mortgage Corporation, or investment in a small business investment company. Further, the prohibitions would not apply to investments or activities conducted by a foreign-organized company whose business is conducted outside the United States or a company that does no business inside the United States except as incident to its international business, provided that the company is not directly or indirectly controlled by a company that is organized under the laws of the United States. **Senate Bill § 619(a)(2) (pp. 476-477).**

It is important to note that the prohibitions on proprietary trading and on engaging in covered transactions with hedge funds and private equity funds would extend not only to depository institutions and companies engaged primarily in financial activities, but also to any "company that controls an insured depository institution" or is treated as a bank holding company, and any of their subsidiaries. However, the additional capital requirements and quantitative limitations to be adopted by the Fed would apply only to 'nonbank financial

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[12] The terms "hedge fund" and "private equity fund" would be defined broadly to mean :a company or other entity that is exempt from registration as an investment company pursuant to section 3(c)(1) or 3(c)(7) of the Investment Company Act… or a similar fund, as jointly determined by the appropriate Federal banking agencies." **Senate Bill § 619(a) (pp. 476-478).**

companies supervised by the Fed' that engage in proprietary trading or sponsoring and investing in hedge funds and private equity funds. **Senate Bill § 619(a) (pp. 482-483).**

The appropriate Federal agencies would also be required to place limitations on the relationships that banks, their affiliates and bank holding companies can have with hedge funds and private equity funds. When a bank, or its subsidiary or bank holding company, serves as an investment manager or adviser to a hedge or private equity fund, it would not be able to enter into covered transactions with the fund, and the fund as treated as if it were an affiliate of the bank. **Senate Bill § 619(e) (pp. 483-483).**

The Senate Bill also directs the Fed to adopt rules imposing additional capital requirements and quantitative limits on nonbank financial companies supervised by the Fed under Section 113 of the Senate Bill, which engage in proprietary trading or sponsoring and investing in hedge funds and private equity funds. **Senate Bill § 619(f) (pp. 483-484).**

The Council would also be required to complete a study of the definitions in the subsection within six months of the date of enactment of the Senate Bill, to assess the extent the definitions; promote and enhance the safety and soundness of depository institutions and their affiliates; protect taxpayers and enhance financial stability by minimizing risk that the depository institutions and their affiliates will engage in unsafe activities; limit inappropriate transfers of Federal subsidies; reduce inappropriate conflicts of interest between depository institutions and their affiliates; raise the cost of credit; and limit activities that cause risk or loss in depository institutions. **Senate Bill § 619(g) (pp. 484-487).** The Council would then be required to make recommendations regarding the definitions and the implementation of the Volcker provision, including any modification to the definitions, prohibitions and requirements. Within nine months of the date the study is completed, the appropriate Federal banking agencies and the Fed would jointly issue final regulations implementing the Volcker provisions. **Senate Bill § 619(g) (pp. 484-487).**

House Bill

The House Bill contains a much more limited application of the Volcker concept, under which the Fed is given the discretionary ability to take affirmative action to prohibit fairly narrowly defined "proprietary trading". Under Section 1117 of the House Bill, the Fed could (but would not be required to) prohibit proprietary trading by a financial holding company subject to stricter standards if it determines that the trading poses a threat to the safety and soundness of the company or to U.S. financial stability. **H.R. 4173 § 1117(a) (p. 136)**. Moreover, the Fed could exempt from this prohibition any proprietary trading that the Board determines is "ancillary" to other operations of the company and that does not threaten the company or U.S. financial stability, including specifically market making, hedging or managing risk, determining the market value of an asset, or for any other proprietary trading for a purpose "allowed by the Board by rule". **H.R. 4173 § 1117(b) (p. 136)**. "Proprietary trading", for this purpose, is defined as "trading of stocks, bonds, options, commodities, derivatives, or other financial instruments with the company's own money and for the company's own account". **H.R. 4173 § 1117(e) (p. 137)**.

P. Concentration Limits on Large Financial Firms

The Senate Bill would amend BHC Act by adding a new Section 13 titled "Concentration Limits on Large Financial Firms" that would place a concentration limit on large financial firms such that, subject to recommendations by the Council, a financial company may not merge or consolidate with, acquire all or substantially all of the assets of, or otherwise acquire control of another company if the total consolidated liabilities of the acquiring financial company would exceed 10% of the aggregate consolidated liabilities of all financial companies at the end of the year, as a result of the transaction. This limit will not, however, apply to an acquisition of a bank in default or in danger of default, or transactions for which the FDIC provides assistance, or those that would result only in a de minimis increase in liabilities. **Senate Bill § 620 (pp. 489-493); H.R. 4173 § 1104(c) (pp. 66-69)** (setting concentration limit on credit exposure of financial holding companies subject to stricter standards of 25% of capital stock and surplus).

TITLE VII — IMPROVEMENTS TO REGULATION OF OVER-THE-COUNTER DERIVATIVES MARKETS

When the Senate Bill was reported out of committee, the language of Title VII, imposing new regulations on the over-the-counter derivatives markets, widely was considered to be placeholder language. Senate Banking Chairman Dodd (D-CT) assigned Senators Reed (D-RI) and Gregg (R-NH) the task of drafting bipartisan language to replace the title. At the same time, Senate Agriculture Committee Chairman Lincoln (D-AK) was working on her own draft to be agreed upon by the committee she chairs. Many believed her draft would reflect bipartisan negotiations with her ranking member, Senator Chambliss (R-GA). Negotiations between Senators Reed and Gregg, however, never yielded an agreement and negotiations between Senators Lincoln and Chambliss ultimately broke down. Instead of delivering a more moderate legislative approach, Chairman Lincoln offered a version of the legislation that has been widely criticized by the business community. The Senate Agriculture Committee reported the bill largely along party lines, with one Republican vote from Senator Grassley (R-IA). Thereafter, Senators Dodd and Lincoln put forth the Dodd-Lincoln substitute amendment, containing the derivatives bill as reported by the Agriculture Committee, which became the base text for Title VII of the Senate Bill.

The Dodd-Lincoln substitute replaces Title VII. While the bill was on the Senate floor, several amendments were offered that would have changed the title significantly, including Senator Chambliss's substitute amendment, which reflected his negotiations with Senator Lincoln, and Senator Dorgan's (D-ND) amendment to ban naked credit default swaps. These amendments failed, however, and the underlying Dodd-Lincoln text emerged nearly intact. The following summary addresses the Dodd-Lincoln Title VII language and compares its major points to the House-passed version of H.R. 4173 Title III.[13]

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

1. Short Title

Senate: The Senate short title is the "Wall Street Transparency and Accountability Act of 2010." (Sec. 701; p. 493)[14]

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[13] For ease of reference, the term "[security-based] swap" refers to security-based swaps and non security-based swaps. The "relevant Commission" for swaps is the CFTC, and for non-security-based security-based swaps, is the SEC. Page and section numbers refer to the Dodd-Lincoln Substitute Amendment prior to the inclusion of changes made by amendments on the Senate floor.

[14] Page number references to the Senate Bill in this discussion of Title VII refer to the pagination of the Dodd-Lincoln Substitute Amendment.

House: The House short title is the "Derivative Markets Transparency and Accountability Act of 2009." (Sec. 3001; p. 558)

2. Regulatory Authority

The CFTC and SEC each must prescribe regulations necessary to carry out the title in consultation and coordination with each other and taking into consideration the views of the prudential regulators. Regulations must be issued not later than 180 days after enactment. Regulations must treat functionally or economically similar products in a similar manner. The CFTC and SEC shall prescribe joint regulations for mixed swaps. If either Commission objects to a regulation, the Commission may appeal the regulation to the United States Court of Appeals for the District of Columbia Circuit.

The SEC and CFTC must consult with each other to adopt rules regarding uncleared swaps requiring the maintenance of records regarding transactions in [security-based] swaps and to make that information available to each other.

The Title provides that unless otherwise specified, the SEC and CFTC shall promulgate rules and regulations separately, not jointly, and the rules and regulations required of each Commission must be promulgated no later than 180 days after the enactment date. Both Commissions may use expedited or emergency procedures to carry out the title.

Within 180 days of enactment, the SEC, CFTC and prudential regulators must submit recommendations to Congress for legislative changes to Federal laws to facilitate the portfolio margining of securities, commodity futures and options, commodity options, swaps and other financial instrument positions. (Sec. 712; p. 494)

Conference Committee Key Point: Regulators have expressed concern that even the 210 day deadline for promulgating regulations prescribed by the House bill would not allow them enough time to address the many issues raised in this Title. It is likely that the deadline will be a point of debate in conference.

3. Abusive Swaps

The CFTC or SEC may collect information regarding the markets for any types of [security-based] swap and issue a report with respect to any type of [security-based] swap that the CFTC or SEC determines to be detrimental to the stability of a financial market or participants in a market. (Sec. 714; p. 503-04)

4. Authority to Prohibit Participation in Swap Activities

If the CFTC or SEC determines that a foreign company's regulation of [security-based] swaps undermine the U.S. financial system stability, then either Commission, in consultation with the Secretary of Treasury, may prohibit an entity domiciled in the foreign country from participating in the United States in any [security-based] swap activity. (Sec. 715; p. 504)

5. Prohibition Against Federal Government Bailout of Swaps Entities

No federal assistance may be provided to any swaps entity with respect to any [security-based] swap or activity of the swaps entity. "Federal assistance" includes the use of any funds, including advances from any Fed credit facility, discount window, FDIC insurance, or guarantees for the purpose of making a loan to or purchasing stock in a swaps entity, purchase any swaps entity's assets, or guaranteeing their debt. "Swaps entities" include [security-based] swaps dealers, major [security-based] swap participants, swap execution facilities, designated contract markets, national securities exchanges, central counterparties, clearing houses, clearing agencies, and registered derivatives clearing organizations. (Sec. 716, pp. 513-15).

This is the provision that would effectively require banks and their holding companies to spin-off swap dealer affiliates.

House Bill

There is no parallel provision in the House Bill.

Conference Committee Key Point: This provision likely will be one of the most contentious during the conference. The provision effectively would require all FDIC-insured companies to spin off their derivatives activities. The House bill contains no similar provision. Senate Agriculture Chairman Lincoln added this provision to the title. Initially, it was thought that the provision may be removed on the Senate floor after the results of Senator Lincoln's primary race in Arkansas were known, but she is now engaged in a tight run-off race. Members on both sides of the aisle have expressed opposition to the provision because they fear that it would cause financial institutions to move their derivatives businesses overseas. Representative McMahon (D-NY) is working on behalf of the New Democrat coalition to remove the provision in conference. Representative Ackerman (D-NY) has circulated a letter to other House members expressing his opposition to the provision.

6. New Product Approval – CFTC-SEC Process

Title VII amends the Commodity Exchange Act (CEA) and the Securities Exchange Act of 1934 ('34 Act) to give the CFTC authority to regulate swaps and the SEC authority to regulate security-based swaps. Certification of new products is stayed pending the determination by the relevant Commission that the product is a swap or security-based swap. (Sec. 717, p. 506-10)

7. Determining the Status of Novel Derivative Products

A person filing a proposal to list or trade a novel derivative product that may have characteristics of a swap and a security-based swap may file concurrently with the SEC and CFTC. Even if no notice of concurrent filing is given, however, the SEC or CFTC may ask the other Commission to render judgment on the product's category . The SEC or CFTC must issue the determination within 120 days of the receipt of the request. The SEC or CFTC may petition the D.C. Circuit Court of Appeals regarding a final order of the other Commission with respect to a novel derivative product. (Sec. 718; p. 510-516)

B. Regulation of [Security-Based] Swap Markets

1. Definitions

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

Major [Security-Based] Swap Participant

The MSP definition includes "any person who is not a [security-based] swap dealer, and – (i) maintains a substantial position in [security-based] swaps for any of the major [security-based] swap categories as determined by the Commission, excluding – (I) positions held for hedging or mitigating commercial risk; and (II) positions maintained by any employee benefit plan . . . for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan; or (ii) whose outstanding [security-based] swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or (iii)(I) is a financial entity, other than an entity predominantly engaged in providing financing for the purchase of an affiliate's merchandise or manufactured goods, that is highly leveraged relative to the amount of capital it holds; and (II) maintains a substantial position in outstanding [security-based] swaps in any major [security-based] swap category as determined by the Commission." The relevant Commission shall define the term "substantial position." In setting capital requirements for a person that is designated as an MSP for a single type of [security-based] swap, the prudential regulator and relevant Commission shall consider the other swaps *and activities* the person engages in that are not otherwise subject to regulation. (Sec. 721, pp. 530-32 and Sec. 761, pp. 765-68, emphasis supplied)

Conference Committee Key Point: The major swap participant definition has been a point of contention throughout the debate on derivatives regulation reform. The House definition is more narrowly tailored and less likely to capture end users using swaps to hedge their risk. The broader Senate definition was drafted several months after the House version and reflects the rising tide of populist sentiment.

[Security-Based] Swap

The terms "security-based swap" and "swap" include a wide variety of derivative transactions enumerated in the definitions. Significantly, the definitions explicitly include foreign exchange swaps and state that foreign exchange swaps and forwards shall be considered swaps unless the Treasury Secretary makes a written determination that they should not be regulated as swaps. Even if they are not regulated as swaps, they must be reported to a swap data repository or the CFTC. The definitions specifically exclude any contract of sale of a commodity for future delivery, leverage contract, security futures product, and any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled. (Sec. 721, pp. 535-45 and Sec. 761, pp. 768-70)

[Security-Based] Swap Dealer

"[Security-based] swap dealer" means "any person who (i) holds itself out as a dealer in [security-based] swaps; (ii) makes a market in [security-based] swaps; (iii) regularly engages in

the purchase and sale of [security-based] swaps in the ordinary course of business; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in [security-based] swaps." The definition excludes a person that busy or sells [security-based] swaps for the person's own account, either individually or in a fiduciary capacity. If a person is designated a [security-based] swap dealer for a single [security-based] swap, then the relevant Commission shall consider the [security-based] swap dealers other activities when setting capital requirements. (Sec. 721, pp. 546-47 and Sec. 761, pp. 772-73)

Note that the way the exclusion language is drafted, an entity that executes swaps only for related entities (e.g., affiliates, parent) could be a "swap dealer", as there is no "market-making" requirement within the swap dealer definition.

2. Preemption of State Insurance Law

The Title provides that a swap shall not be considered to be insurance and may not be regulated as an insurance contract under State law. This preemption provision has been strongly supported by end-users and others engaged in the OTC market who fear that the cost of complying with a patchwork of state insurance regulations would far outweigh the benefits of continuing their hedging activities in the derivatives market, and thereby eliminating one of their key risk-reduction tools. (Sec. 722, p. 553-54)

Conference Committee Key Point: The Senate bill would preempt states from regulating derivative contracts as insurance, while the House bill is silent on the issue. This provision is important for the business community, which fears that it will have to comply with a patchwork of state laws if states have authority to regulate derivatives as insurance. The National Conference of Insurance Legislators, which consists of state legislators whose main area of public policy concern is insurance, considered model legislation last year, and legislation has been offered in the New York State Assembly.

3. Clearing, Reporting, and Trade Execution

Title VII provides that any person who is a party to a [security-based] swap shall submit the swap for clearing to a derivatives clearing organization (for swaps) or to a clearing agency (for security-based swaps). Before clearing a new type of [security-based] swap, the DCO or clearing agency must submit the type of [security-based] swap to the relevant Commission for prior approval. The Commission must take action within 90 days after the submission of the request. The Commissions individually shall adopt rules to govern the submission requirements and also to govern the clearing of the [security-based] swaps once they are accepted. A Commission may stay the clearing requirement while it reviews a submission. The Commissions also must identify [security-based] swaps required to be accepted for clearing. The SEC and CFTC must use expedited rulemaking procedures to adopt rules without regard for otherwise-required notice and comment provisions.

Both counterparties to an uncleared [security-based] swap shall report the [security-based] swap to a registered [security-based] swap repository, or if there is no repository that will accept the [security-based] swap, then to the relevant Commission. [Security-based] swaps entered into before the enactment date must be reported to a registered repository or the relevant

Commission not later than 180 days after the effective date. [Security-based] swaps entered into on or after the enactment date but before the effective date must be reported not later than 90 days after the effective date, or such other time as prescribed by the relevant Commission.

[Security-based] swaps entered into before the enactment date are exempt from the clearing requirements if they are reported, as are [security-based] swaps entered into before application of the clearing requirement.

Counterparties to [security-based] swaps subject to the clearing requirement must execute the transactions on a board of trade designated as a contract market (for swaps) or on an exchange or swap execution facility (for security-based swaps). This requirement will not apply if no board of trade or exchange or swap execution facility makes the [security-based] swap available to trade or if a commercial end user counterparty opts to use its clearing exemption. (Sec. 723, pp. 558-71 and Sec. 763, pp. 782-94)

4. End-User Clearing Exemption

The Senate Bill defines "commercial end user" as "any person other than a financial entity described in clause (ii) who, as its primary business activity, owns, uses, produces, processes, manufactures, distributes, merchandises, or markets goods, services or commodities (which shall include but not be limited to coal, natural gas, electricity, ethanol, crude oil, gasoline, propane, distillates, and other hydrocarbons) either individually or in a fiduciary capacity." In clause (ii), the bill defines "financial entity" as (I) a [security-based] swap dealer or MSP; (II) a person in the business of banking or financial in nature; (III) a person engaged in activities that are predominantly financial in nature; (IV) a commodity pool or private fund; or (V) a person registered or required to be registered with the CFTC or SEC (but does not include a public company which registers its securities with the SEC).

The bill provides that if a [security-based] swap otherwise would be subject to the mandatory clearing requirement and one of the counterparties is a commercial end user, the end user counterparty may elect not to clear the [security-based] swap, but if it does choose to clear the swap, then the end user may select the derivatives clearing organization at which the [security-based] swap will be cleared. The end user only may elect not to clear the [security-based] swap if it is using the [security-based] swap to hedge its own commercial risk. Affiliates of commercial end users may use the clearing exemption only if they are using it as an agent of the end user to hedge the risk of the commercial end user. Affiliates of commercial end users (including captive finance affiliates) may not use the exemption at all if the affiliates are [security-based] swap dealers, MSPs, investment companies, commodity pools, bank holding companies with over $50,000,000,000 in consolidated assets, or an affiliate of any of those entities.

If a counterparty is an issuer of securities, exemptions from the clearing and trading requirements for security-based swaps shall be available only if the issuer's audit committee has approved the issuer's decision to enter those security-based swaps.

(Sec. 723, pp. 571-76 and Sec. 763, pp.794-807).

Conference Committee Key Point: The Senate end user exemption is much narrower than the House version, again reflecting the increase in populist sentiment.

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

For any person to accept remuneration from a [security-based] swaps customer to margin, guarantee, or secure a [security-based] swap cleared by a derivatives clearing organization or clearing agency, the person must register with the CFTC as a futures commission merchant or with the SEC as a broker, dealer, or security-based swap dealer. Futures commission merchants and brokers, dealers, and security-based swap dealers must treat all money, securities, and property of [security-based] swaps customers received to margin, guarantee, or secure a cleared swap as belonging to the [security-based] swaps customer. They shall not be commingled with the funds of the futures commission merchant, broker, dealer, or security-based swap dealer or used on behalf of any person other than the person for whom they are held. The funds, however, may be commingled and deposited in the same one or more bank accounts with any bank, trust company, or derivatives clearing organization. The money may be invested in obligations of the United States or any State or in obligations guaranteed by the United States. (Sec. 724, pp. 579-83 and Sec. 763, pp. 824-28)

6. Segregation Requirements for Uncleared Swaps

Swap dealers and MSPs will be required to notify their counterparties at the beginning of a transaction that the counterparties have the right to require segregation of funds or other property supplied to margin, guarantee, or secure the obligations of the counterparty. If a counterparty requests segregation of assets, the swap dealer or MSP must segregate the funds and maintain them in a separate account. The segregation requirement does not apply to variation margin payments. If the counterparty does not choose to require segregation of the funds or property, then the swap dealer or MSP shall report to its counterparty on a quarterly basis that the it is in compliance with the back office procedures agreed upon by the parties. (Sec. 724, pp. 583-86).

7. Derivatives Clearing Organizations and Clearing Agencies

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

The CFTC must adopt rules mitigating conflicts of interest in connection with the conduct of business by a swap dealer or MSP with a derivatives clearing organization, board of trade, or swap execution facility that clears or trades swaps in which the swap dealer or MSP, has

a material interest. Reported information from the DCOs will be shared with the SEC and other regulators. (Sec. 725, pp. 586-613)

Registered DCOs whose principal business is clearing commodity futures and options on commodity futures transactions and swaps are exempt from the registration requirements for clearing agencies for security-based swaps unless the SEC finds that the DCO is not subject to comparable regulation by the CFTC. (Sec. 763 p. 809-10)

Similarly, clearing agencies must register with the SEC and comply with standards set by the SEC. They must designate a chief compliance officer to report to the board, resolve conflicts of interest in consultation with the board, administer policies and procedures, ensure compliance with this Title, and prepare and sign annual reports. The SEC must adopt rules governing clearing agencies for security-based swaps. The SEC may exempt clearing agencies from registration if the SEC finds that the agency is subject to comparable regulation by the CFTC or its home country authorities. (Sec. 763, pp. 808-09)

8. Conflict of Interest Rulemaking

Within 180 days of enactment, the CFTC must determine whether to adopt rules to establish limits on the control of any derivatives clearing organization that clears swap, or swap execution facilities or boards of trade designated as contract markets that post swaps or makes swaps available for trading, by a bank holding company with total consolidated assets of $50,000,000,000 or more, a nonbank financial company supervised by the Fed, an affiliate of such a bank or nonbank holding company, a swap dealer, a major swap participant, or an associated person of a swap dealer or MSP. (Sec. 726, pp. 613-14)

Likewise, within 180 days of enactment, the SEC must determine whether to adopt rules to establish limits on the control of any clearing agency that clears security-based swaps or on the control of any security-based swap execution facility or national securities exchange that posts security-based swaps by a bank holding company with total consolidated assets of $50,000,000,000 or more, a nonbank financial company supervised by the Fed, an affiliate of such a bank or nonbank holding company, a [security-based] swap dealer, a major [security-based] swap participant, or an associated person of a such a person. (Sec. 765, p. 878-79)

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

The relevant Commission is required to provide by rule for the public availability of [security-based] swap transaction and pricing data. The CFTC or SEC must require real-time public reporting for all cleared [security-based] swaps. Aggregate data on uncleared [security-based] swaps shall be made available in a manner that does not identify individual transactions or positions. (Sec. 727, pp. 615-19 and Sec. 763, pp. 800-04, 836-38)

10. [Security-Based] Swap Data Repositories

[Security-based] swap data repositories must register with the relevant Commission, must comply with enumerated core principles, and must share information with the other relevant Commission upon request and with other regulators. [Security-based] swap data repositories are to accept data prescribed by the SEC or CFTC for each [security-based] swap, confirm the

accuracy of the data submitted with both counterparties, and maintain the data as prescribed by the CFTC or SEC. If directed by the relevant Commission, [security-based] swap data repositories must establish automated systems for monitoring and analyzing [security-based] swap data, including compliance and frequency of end user clearing exemption claims. Each [security-based] swap data repository shall designate a chief compliance officer who will report to the board or senior officer of the [security-based] swap data repository, review the repository's compliance with enumerated core principles, resolve conflicts of interest in conjunction with the board, administer policies and procedures, and prepare and sign an annual report. Among other topics, the core principles address antitrust concerns, governance, reporting, and conflict of interest concerns. (Sec. 728, pp. 619-27 and Sec. 763, pp. 838-47)

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

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

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

Individuals who enter into uncleared [security-based] swaps whose [security-based] swaps are not accepted by a [security-based] swap data repository for reporting must provide reports regarding the [security-based] swaps to the CFTC or SEC upon written request from the relevant Commission and must maintain books and records relating to the [security-based] swaps which are open to inspection by the CFTC, SEC and other regulators. (Sec. 729, pp. 627-31 and Sec. 763 pp. 804-05, 836-39 and Sec. 766, pp. 879-85)

12. Large Trader Reporting:

Title VII would make it unlawful for any person to enter into any swap that the CFTC determines performs a significant price discovery function with respect to registered entities if the person directly or indirectly exceeds the CFTC's daily position limits or other position limits. The Title provides an exemption if the person files a report with the CFTC regarding the transaction and keeps books and records on the transaction which are open to the CFTC and SEC. (Sec. 730, pp. 631-34)

The SEC also may require reporting of large positions in security-based swaps and securities, loans, or index of securities or loans or other instruments that relate to the security-based swaps. (Sec. 763, p. 833)

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

[Security-based] swap dealers and MSPs must register with the relevant Commission. The CFTC and SEC must issue rules under these sections which shall provide for the registration of [security-based] swap dealers and MSPs not later than one year after the enactment date. [Security-based] swap dealers and MSPs must register with the CFTC, even if they already are registered with the SEC, and vice versa. (Sec. 731, pp. 634-37 and Sec. 764, pp. 847-51)

14. Capital and Margin Requirements

[Security-based] swap dealers and MSPs that are depository institutions shall meet minimum capital and minimum initial and variation margin requirements set by the appropriate federal banking agency in consultation with the SEC and CFTC. Nondepository [security-based] swap dealers and MSPs must meet minimum capital and minimum initial and variation margin requirements set by the relevant Commission.

The capital requirements for depository institutions must contain a capital requirement that is greater than zero for cleared [security-based] swaps and a “substantially higher” capital requirement for uncleared [security-based] swaps. Capital requirements for nondepository institutions shall be “as strict as or stricter than” the capital requirements for the depository institutions.

Futures commission merchants, introducing brokers, brokers, and dealers must maintain sufficient capital to comply with the stricter of either of the above capital requirements.

The appropriate Federal banking agency for depository institution [security-based] swap dealers and MSPs will impose initial and variation margin requirements on all uncleared [security-based] swaps. The SEC and CFTC will impose “as strict or stricter than” requirements on nondepository institutions swap dealers and MSPs for uncleared [security-based] swaps. The Federal banking agency may permit the use of noncash collateral as the agency or CFTC or SEC determine to be consistent with preserving the financial integrity of the markets and United States stability. Note that, as the language is currently drafted, it appears that margin requirements would apply to captive finance affiliates that are exempt from the clearing requirements.

The SEC, CFTC, and Federal banking agencies must consult at least annually on minimum capital and margin requirements and to the maximum extent possible, maintain comparable requirements to each other.

If any party exempt from margin requirements requests that a [security-based] swap be margined, then the exemption shall not apply and the counterparties must post margin.

Margin requirements shall not apply to initial and variation margin for [security-based] swaps in which one of the counterparties is not a [security-based] swap dealer, a MSP, or a financial entity that is eligible for and utilizing the commercial end user clearing exemption.

(Sec. 731, pp. 637-45 and Sec. 764, pp. 851-59)

Conference Committee Key Point: The conferees likely will debate whether existing derivatives contracts should be exempt from margin requirements with a grandfather provision similar to the grandfather provision for clearing derivatives, which is included in both bills. Senator Dodd, whose word will carry weight among the conferees, has expressed opposition to grandfathering existing contracts for margining purposes. Conferees also probably will discuss whether capital requirements for uncleared swaps should be "substantially higher" than for cleared swaps.

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

Each registered [security-based] swap dealer and MSP shall make reports required by the relevant Commission regarding transactions, positions, and financial condition of the entity and must maintain books and records as prescribed by the relevant Commission which they keep open for inspection. Each registered [security-based] swap dealer and MSP must maintain daily trading records and recorded communications as required by the CFTC or SEC and must maintain a complete audit trail for conducting trade reconstructions. (Sec. 731, pp. 645-47 and Sec. 764, pp. 859-61)

16. Business Conduct Standards; Documentation and Back Office Standards

Each registered [security-based] swap dealer and MSP must conform with business conduct standards prescribed by the relevant Commission regarding fraud, manipulation and other abusive practices, supervision of its business, and adherence to position limits. [Security-based] swap dealers that provide advice to or engage in [security-based] swaps with a Federal, State, or local government or with a pension plan, endowment, or retirement plan, shall have a fiduciary duty to the government or agency or to the pension plan, endowment, or retirement plan.

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

Each registered [security-based] swap dealer and MSP must conform with the relevant Commission's standards regarding the timely and accurate confirmation, processing, netting, documentation, and valuation of all [security-based] swaps. The relevant Commission shall adopt rules governing documentation and back office standards. (Sec. 731, pp. 647-52 and Sec. 764 pp. 861-66)

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

Registered [security-based] swap participants and MSPs must monitor trading in [security-based] swaps to avoid violating position limits, must establish risk management systems, disclose information to regulators about their [security-based] swap transactions, and shall establish internal systems to obtain necessary information to fulfill these duties. [Security-based] swap participants and MSPs must implement conflict of interest systems and must avoid violating antitrust principles. They must designate a chief compliance officer who will report to the board or senior officer, review compliance with duties, and resolve conflicts of interest in consultation with the board. The compliance officer must administer policies and procedures, ensure compliance with this Act, establish procedures for remedying noncompliance, and prepare and sign an annual report. (Sec. 731, pp. 652-57 and Sec. 764, pp. 866-72)

18. Futures Commission Merchants and Introducing Brokers Conflicts of Interest

The CFTC shall require that futures commission merchants and introducing brokers implement conflict of interest systems which will establish firewalls between researchers and analysts on the one side, and those people involved in trading and clearing on the other. Futures commission merchants also must designate a chief compliance officer to report to the board, review compliance with the Act, establish policies and procedures, and to prepare and sign annual reports. (Sec. 732, pp. 657-60)

19. [Security-Based] Swap Execution Facilities

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

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

To be registered as a [security-based] swap execution facility, the facility must comply with enumerated core principles, including compliance with rules and enforcement of trading rules. The [security-based] swap execution facility shall permit trading only in [security-based] swaps not readily susceptible to manipulation and shall monitor trading and trade processing. It shall have the ability to obtain internal information and shall adopt position limits for speculators when necessary at a level no higher than the CFTC or SEC limitation. It shall ensure the financial integrity of [security-based] swaps entered on its facility, have the ability to exercise emergency authority, and maintain books and records as required by the CFTC or SEC. The

core principles also address conflicts of interest, financial resources, and system safeguards, and require the designation of a chief compliance officer. The SEC or CFTC may exempt a [security-based] swap execution facility from registration if the Commission finds that the facility is subject to comparable oversight by the other Commission. (Sec. 733, pp. 661-73 and Sec. 763 pp. 810-24)

20. Designated Contract Markets

To be designated as a contract market, a board of trade must comply with enumerated core principles and must establish, monitor and enforce the rules of the contract market including regarding access requirements, the terms and conditions of contracts to be traded on the market, and rules prohibiting abusive trading practices. The core principles include requirements that: The board of trade may not list contracts readily susceptible to manipulation and the board shall adopt position limits as necessary for speculators not higher than the CFTC's limit. The board must have the ability to use emergency authority. The board shall make information regarding the terms and conditions of the contracts of the market, rules of the market, and information regarding the operation of the market available to regulators, market participants and the public. It shall make daily trading information public, protect the financial integrity of transactions, and protect market participants from abusive practices. It shall have in place disciplinary and dispute resolution procedures and governance fitness standards and take into account antitrust considerations. (Sec. 735, pp. 674-84)

21. Position Limits

The CFTC shall establish limits, including related hedge exemption provisions, on the aggregate number or amount of positions in contracts based on the same underlying commodity that may be held by any person for each month across contracts listed by designated contract markets, contracts traded on a foreign board of exchange, swaps traded on a swap execution facility, and swaps that perform a significant price discovery function with respect to a registered entity. The CFTC may exempt any person, class of person, swap, or class of swaps from position limits. (Sec. 737, pp. 685-89).

Similarly, the SEC shall establish position limits on the size of positions in any security-based swap that may be held by any person. In establishing the limits, the SEC may require any person to aggregate positions in security-based swaps and securities or group of securities or loans related to the security-based swap or any security-based swap with any security or index of securities which use the security's price, yield, value, or volatility as a material term for the security-based swap. The SEC may exempt any person, class of person, security-based swap, or class of security-based swaps or transactions from any position limit requirements. The SEC also may direct self-regulatory organizations to adopt position limits. The SROs may require people to aggregate their positions. (Sec. 763, pp. 830-33).

22. Foreign Boards of Trade

Foreign boards of trade may not provide participants located in the United States direct access to their electronic trading system unless the CFTC determines that the FBOT makes daily trading information public and the FBOT adopts position limits, has authority to require

participants to limit or reduce their positions to prevent manipulation and excessive speculation, and agrees to share information with the CFTC. The section will not affect FBOTS to which the CFTC already has granted direct access permission until 180 days after enactment. (Sec. 738, pp. 689-795)

23. Legal Certainty for Swaps

The Senate Bill provides that hybrid instruments and swaps shall not be void for failure to comply with the Act or CFTC regulations. Swaps entered into before the date of enactment will not be subject to the mandatory clearing requirement. Position limits shall not apply to a position acquired in good faith prior to the effective date of any rule, regulation, or order establishing position limits, but those positions will be attributed to the trader if the trader's position is increased after the effective date of a position limit. (Sec. 739, pp. 695-98)

24. Enforcement

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

The SEC shall censure, limit the activities of, or revoke the registration of any security-based swap dealer or MSP if the SEC finds after notice and opportunity for a hearing that the punishment is in the public interest and that the dealer or MSP has committed various violations of securities law. (Sec. 741, pp. 698-706 and Sec. 764, pp. 872-78).

25. Enhanced Compliance by Registered Entities

To be designated as and maintain the designation of a board of trade as a contract market, the board must comply with enumerated core principles. To accept a new product for trading or clearing or approve a new rule, it must certify in writing to the CFTC that the product or rule complies with the Act. Rules will become effective ten business days after the CFTC receives the certification, unless the CFTC notifies the registered entity otherwise, which shall stay the certification up to 90 additional days. The rule will become effective after the 90 days unless the CFTC withdraws the stay or notifies the registered entity that it objects to the rule. The registered entity also can seek prior CFTC approval for contracts or rules. (Sec. 745, pp. 713-21)

26. Insider Trading, Antidisruptive Practices

The Title prohibits insider trading related to swaps or the sharing of nonpublic information for personal gain, as well as the knowing use of nonpublic information in swaps trading. (Sec. 746, pp. 721-25) The Title also prohibits engaging in disruptive practices, such as violating bids or offers or spoofing, as well as using swaps to defraud others. (Sec. 747, pp. 725-27).

27. Whistleblowers

The Title gives the CFTC authority to determine the amount of awards to give to whistleblowers and provides protections for whistleblowers, including protection from retaliation. It also establishes a fund to pay whistleblowers. (Sec. 748, pp. 727-43).

28. International Harmonization

The SEC, CFTC, Financial Stability Oversight Council, and Treasury Department shall individually and collectively work with foreign regulatory authorities to establish consistent international standards for the regulation of swaps and enter into information-sharing arrangements. (Sec. 752, pp. 750-51)

29. Effective Date

Unless otherwise provided, the derivatives provisions will take effect 180 days after enactment. (Sec. 754, p. 763 and Sec. 773, p. 891)

Conference Committee Key Point: The effective date of the derivatives title will be a source of debate for the conference committee. The House Bill provides a blanket 210 days for implementation, while the Senate Bill provides 180 days. Regulators would be hard-pressed to issue the number of rules required by the derivatives title within either of those amounts of time.

TITLE VIII — PAYMENT, CLEARING, AND SETTLEMENT SUPERVISION

This Title, which is intended to ensure the safe and efficient clearing and settlement of payment, securities and other financial transactions, is to be cited as the "Payment, Clearing and Settlement Supervision Act of 2010". **Senate Bill §§ 801 (p. 891).**

A. Purpose

The legislation's findings and purposes discussion states that while "financial market utilities" that support multilateral payment, clearing or settlement activities may reduce some risks, they also concentrate and create new risks. **Senate Bill § 802(a)(2) (p. 892).** Moreover, the section lists the following reasons why it is necessary to enhance regulation of "systemically important financial market utilities" and "systemically important payment, clearing, and settlement activities":

- To provide consistency;
- To promote robust risk management and safety and soundness;
- To reduce systemic risks; and
- To support the stability of the broader financial system.

Senate Bill § 802(a)(4) (p. 892); See, also, Senate Bill § 805(b) (p. 906).

To these ends, the legislation would give the Fed authority to prescribe uniform standards for the management of risks by systemically important financial market utilities ("utilities") and for the conduct of systemically important payment, clearing, and settlement activities by financial institutions ("activities"). **Senate Bill § 802(b)(1) (p. 893).** The Fed would have an enhanced role in the supervision of risk management standards for both utilities and activities. **Senate Bill §§ 802(b)(2) and (4) (p. 893).** Moreover, the proposal is designed to strengthen the liquidity of utilities. **Senate Bill § 802(b)(3) (p. 893).**

B. Scope of Regulatory Authority

Broad categories of entities and activities could be subject to enhanced Fed authority under the proposal. The Council would, for example, by a 2/3 vote including the vote of the Chairperson, have authority to designate both the activities and utilities considered "systemically important". **Senate Bill §§ 803(1) and (2) (p. 894)and Senate Bill § 804(a)(1) (p. 900).**[15] In addition, "financial institution" would broadly include all depository institutions, foreign bank

[15] Rescission of designation as systemically important would also require a 2/3 vote of the Council and the affirmative vote of the Chairperson. **Senate Bill § 804(b) (pp. 901-902).**

branches, organizations operating under §§ 25 or 25A of the Federal Reserve Act, credit unions, brokers and dealers, investment companies, insurance companies, investment advisers, future commission merchants, commodity trading advisors, commodity pool operators, and any company engaged in activities that are financial in nature under BHC Act § 4. **Senate Bill §§ 803(4) (pp. 894-895).**

Similarly, "financial market utility" would include any person managing or operating a multilateral system for transferring, clearing or settling payments, securities, or other financial transactions. **Senate Bill §§ 803(5) (p. 896)** The term "financial transactions", in turn, would be defined through an extensive list including fund transfers, securities contracts, commodity sales, forward contracts, repurchase agreements, various swap agreements, foreign exchange contracts, and financial derivatives contracts. **Senate Bill §§ 804(6)(B) (p. 897).** The Council would also have authority to add any similar transactions it determines are "financial transactions". **Senate Bill §§ 804(6)(B)(xii) (p. 897).**

"Systemic importance" would be found where a failure or disruption could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets. **Senate Bill § 803(9) (p. 900).** In making the "systemically important" designation, the Council would be required to consider:

- The value of transactions processed by the utility or activity;
- The exposure of the utility or a financial institution engaged in activities to its counterparties;
- The relationship, interdependencies, or other interactions of the utility or activity with other utilities or activities; and
- The effect the of failure or disruption to a utility or activity on critical markets, institutions or the broader financial system.

Senate Bill § 804(a)(2) (pp. 900-901).

Note, also, that one of the duties of the Council would be to annually report Congress on all determinations made under Title VIII. **Senate Bill § 112(a)(2)(M)(iii) (p. 30).**

C. Consultation and Notice Requirements

The Council's authority to designate utilities and activities as systemically important would not be unbounded. It is required to consult with the relevant supervisory agency for an institution and the Fed before reaching such a decision. **Senate Bill § 804(c)(1) (p. 902).** In addition, a utility or financial institution engaging in an activity must receive advance notice (including through a notice published by the Council in the Federal Register) and an opportunity to request a written or oral hearing before a determination is reached by the Council. **Senate Bill § 804(c)(2) (pp. 902-904).** The proposal does, however, provide for an emergency exception where the Council may waive the notice requirements by a 2/3 vote and affirmation by the Chairperson where waiver is needed to prevent an immediate threat to the financial system. **Senate Bill § 804(c)(3) (pp. 904-905).**

D. Standards for Utilities and Activities

Under this Title, the Fed would have authority to prescribe risk management standards governing the operations related to payment, clearing, and settlement activities of utilities and the conduct of activities by financial institutions. The Fed could do so by rule or order and must consult with the Council and the relevant supervising agencies. **Senate Bill § 805(a) (p. 906).** The objective is to be to promote risk management, promote safety and soundness, reduce systemic risks, and support broader financial stability. **Senate Bill §805(b) (p. 906).** The Fed's mandate would include regulating:

- Risk management policies and procedures;
- Margin and collateral requirements;
- Participant or counterparty default policies and procedures;
- The ability to complete timely clearing and settlement of financial transactions;
- Capital and financial resource requirements for designated financial market utilities; and
- Other areas the Fed determines are need to achieve objectives.

Senate Bill § 805(c) (pp. 906-907).

E. Operations of Designated Financial Market Utilities

The Fed would have discretion to authorize a Federal Reserve Bank to maintain an account for a designated financial market utility and provide services to the utility that it is authorized under the Federal Reserve Act to provide to a depository institution. **Senate Bill § 806(a).** The Fed can authorize the Federal Reserve Bank to provide the utility discount and borrowing privileges**. Senate Bill § 806(b) (p. 908).** The Bank can also pay earnings on balances maintained by the utility. Senate Bill § 806(c) (p. 736). Also, the Fed can exempt the utility from reserve requirements. **Senate Bill § 806(d) (pp. 908-909).**

A designated financial market utility would be required to provide 60-days advance notice to its supervisory agency and the Fed of any proposed change to its rules, procedures, or operations that could materially affect the nature or level of risk presented by the utility. **Senate Bill § 806(e) (pp. 909-914).** The Fed or supervising agency would be required to notify the utility of any objection within 60-days of the date of notice or date any further information is received. **Senate Bill § 806(e)(1)(E) (p. 910).** The change can not be made if the Fed or supervisory agency so objects, but the utility may make the change if no objection is received within 60 days. **Senate Bill §§ 806(e)(1)(F) and (G) (p. 911).** Note, also, that extensions of time would be available for the Fed and supervisory agencies to review of novel or complex issues. **Senate Bill § 806(e)(1)(H) (pp. 911-912).**

An exception exists for "emergency changes". Where both emergency exists and immediate implementation of a change is needed for the utility to continue service in a safe and

sound matter, the utility may implement a change without notice. **Senate Bill § 806(e)(2) (pp. 912-914).** However, the utility would need to provide its supervisory agency and the Fed notice within 24 hours of the change, which notice must set out the nature of the emergency and the reason the change was needed. **Senate Bill §§ 806(e)(2)(B) and (C) (p. 913).** The supervisory agency or the Fed could require modification or rescission of the policy. **Senate Bill § 806(e)(2)(D) (pp. 913-914).**

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

The supervisory agency for a designated financial market utility would be required to conduct examinations of the utility at least once a year, including to determine the nature of its operations, the risks borne by it, the financial and operational risks it presents to financial institutions, critical markets or the financial system, the resources and capabilities used to monitor and control these risks, its safety and soundness, and its compliance with law and Fed rules. **Senate Bill § 807(a) (pp. 914-915).**

For purposes of the proposed law, note that the "supervisory agency" means the SEC with respect to a utility that is a clearing agency registered with the SEC, the CFTC with respect to a utility that is a derivatives clearing organization registered with the CFTC, the appropriate Federal banking agency with respect to a utility that is described in section 3(q) of the FDI Act, and the Fed with respect to a utility that is not subject to other jurisdiction. **Senate Bill § 803(7)(A) (pp. 898-899).** Note that the supervisory agency would have authority to examine any services provider that is "integral to the operation" of the utility. **Senate Bill § 807(b) (p. 915).** In addition, for any examination, the supervising agency must consult with the Fed and the Fed could participate in the examination. **Senate Bill § 807(d) (p. 916).** The Fed could recommend and submit to the supervising agency recommendations for enforcement action. The supervisory agency must respond to the Fed within 60 days and, if it does not adopt the recommendation, the Fed may dispute the matter by referring the recommendation to the Council for mediation. If the Council is unable to resolve the dispute, then the Fed may vote to exercise enforcement authority as if it were the supervisory agency. **Senate Bill § 807(e) (pp. 916-918).** The Fed could also take emergency enforcement action, upon consultation with the supervisory agency, if it believes that either an action by a utility poses an imminent risk of substantial harm or the condition of the utility poses an imminent risk of substantial harm to financial institutions, critical markets, or the broader financial system. **Senate Bill § 807(f) (pp. 918-919).**

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

The primary financial regulatory agency would be authorized to examine a financial institution with respect to a designated activity to determine the nature and scope of the activities engaged in by the financial institution, the financial and operational risks the activities engaged in pose to the safety and soundness of the financial institution, the financial and operational risks the activities pose to other financial institutions, critical markets, or the broader financial system, the resources available to and the capabilities of the financial institution to monitor and control risks, and the financial institution's compliance with law and Fed rules. **Senate Bill § 808(a) (p. 920).** The Fed would be required to consult with and provide technical assistance to the primary

financial regulator and the regulator could request that the Fed conduct or participate in the examination. **Senate Bill §§ 808(c) and (d)(1) (pp. 921-922).** The regulator could also request that the Fed enforce rules or orders against a financial institution, with the Fed determining whether an enforcement action is warranted. **Senate Bill § 808(d)(2) (pp. 922-923).** The proposal also provides for back-up examination and enforcement authority for the Fed and sets limitations on the Fed's exercise of this authority. **Senate Bill § 808(e) (pp. 923-927).**

H. Requests for Information, Reports, or Records

Before a utility or activity is designated as systemically important, the Council would have authority to require any utility submit information needed to assess whether it is systemically important if the Council has reasonable cause to believe the utility meets the standards for systemic importance. **Senate Bill § 809(a)(1) (pp. 927-928).** The Council would also be authorized to require any financial institution submit information for the sole purpose of assessing whether any payment, clearing, or settlement activity is systemically important, but again only if the Council has reasonable cause to believe it is systemically important. **Senate Bill § 809(a)(2) (p. 928).**

After a utility or activity is designated as systemically important, the Fed and Council would be able to require the designated utility submit reports to the Fed and Council in frequency and form deemed needed by the Fed and Council in order to assess the safety and soundness of the utility and the systemic risk of its operations. **Senate Bill § 809(b)(1) (p. 928).** The Fed and Council would also be able to require that financial institutions engaged in a designated activity submit, in frequency and form deemed needed, reports solely with respect to the conduct of the designated activity to assess whether the Fed's rules with respect to the activity appropriately address the risks to the financial system and whether the financial institutions are in compliance with law and the rules of the Fed. **Senate Bill § 809(b)(2) (p. 929).** The proposal includes provisions requiring coordinating with the appropriate Federal supervisory agency to determine if information is available from the agency before requesting it from the utility or financial institution. **Senate Bill §§ 809(c) and (d) (pp. 929-931).** It also provides for the sharing of information between the Fed, the Council, the primary financial regulatory agency, and any supervising agency. **Senate Bill § 809(e) (p. 931).**

I. Rulemaking

The Fed and Council would be authorized to prescribe rules and issue orders needed to administer the duties granted to them under the proposal. **Senate Bill § 810 (pp. 932-933).**

J. Other Authority

The primary financial regulatory agency, any supervisory agency, or any other Federal or State agency would continue to have any authority under any other applicable law, except that stricter standards required by the Fed under the provision would supersede any less stringent requirements. **Senate Bill § 811 (p. 933).**

K. Effective Date

The proposal would be effective as of the date the Act is enacted. **Senate Bill § 812 (p. 933).**

TITLE IX — INVESTOR PROTECTIONS AND IMPROVEMENTS TO THE REGULATION OF SECURITIES

A. Increasing Investor Protection

1. Investor Advisory Committee

The Senate Bill would establish the Investor Advisory Committee on a permanent basis. This committee would advise and consult with the SEC on regulatory priorities, issues relating to the regulation of securities products, trading strategies, fee structures, and the effectiveness of disclosure, and initiatives to protect investor interest and to promote investor confidence and the integrity of the securities markets. Among others, a representative of the State securities commissions and an "Investor Advocate" would serve on the committee. **Senate Bill § 911 (pp. 933-938)**; **H.R. 4173 § 7101 (p. 1272).**

2. Office of the Investor Advocate

Section 4 of the Exchange Act would be amended to establish the Office of the Investor Advocate, the head of which would report directly to and be appointed by the SEC's Chairman, in consultation with the SEC. Among other things, the Investor Advocate, which would be authorized to retain or employ independent counsel and research and service staff, would be charged with assisting retail investors in resolving significant problems investors have with the SEC or self-regulatory organizations, identify areas in which investors would benefits from changes in SEC or SRO rules, identify problems that investors have with financial service providers and investment product, analyze the potential impact on investors of SEC and SRO rulemaking. The Investor Advocate would be required to prepare an annual report to the Senate Banking Committee and the House Financial Services Committee reporting on a variety of activities related to its objectives. Under new paragraph (5)(g) of Section 4 of the Exchange Act, the Investor Advocate would be given "full access" to the documents of the SEC and any self-regulatory organization, as necessary to carry out its functions. It is unclear how this provision would apply to documents for which protection is sought under the Freedom of Information Act. **Senate Bill § 914 (pp. 948-54).**

3. Investor Testing

The Senate Bill would also amend Section 19 of the Securities Act of 1933 (presumably, this is a typographical error and the drafters meant the Securities Exchange Act of 1934) to allow the SEC to gather information from and consult with members of the public, including investors, as well as academics and consults in connection with considering or conducting rulemaking and to also engage in temporary investor testing programs. **Senate Bill § 912 (pp. 938-39).**

H.R. 4173 would amend Section 38 of the Investment Company Act of 1940 and Section 211 of the Investment Advisers Act of 1940 as well as Section 19 of the Securities Exchange Act of 1934 to provide for gather information and temporary or experimental programs. **H.R. 4173 § 7102 (pp. 1274-1275).**

4. Study and Rulemaking Regarding Obligations of Brokers, Dealers, and Investment Advisers (the "Fiduciary Duty" Provision)

The Senate Bill directs the SEC to conduct a study to evaluate the effectiveness of and gaps or overlaps in the existing legal and regulatory standards of care for brokers, dealers, investments advisers and their associated persons when providing personalized investment advice and recommendations about securities to their respect "retail customers" If the SEC's findings from its study, including the results of any public comments, identify any gaps or overlaps in legal or regulatory standards for the protection of retail investors relating to the standards of care for broker-dealers, investment advisers and their associated persons, the SEC is directed to commence rulemaking within two years of enactment of the Act. **Senate Bill § 913(b) (pp 940-948).**

In contrast, Title V, Section 7103 of H.R. 4173 would explicitly establish a fiduciary duty standard of care for broker-dealers as well as investment advisers. Specifically, new paragraph (m) would be added to Section 15 of the Securities Exchange Act of 1934 that would direct the SEC to promulgate rules to provide that the standard of care for a broker-dealer providing personalized investment advice about securities to a retail customer *as well as any other customers designated by the SEC* would be the same as the standard of conduct applicable to investments adviser pursuant to Section 211 of the Investment Advisers Act of 1940. H.R. 4173 provides that broker-dealers would not violate this standard of conduct simply by receiving commissions or other standard compensation paid to broker-dealers for the sale of securities, and also states that nothing in the statute requires the broker-dealer, or its registered representatives, to have a continuing duty of care or loyalty to the customer after providing personalized investment advice about securities. Nevertheless, this formulation of a duty of care raises significant liability concerns and compliance risks for broker-dealers. **H.R. 4173 § 7103 (p. 1276).**

The Senate's definition of "retail customer" is very limited; *i.e.,* an individual customer of a broker-dealer, investment adviser, or their associated persons. **Senate Bill § 913(a)(pp. 939-40).** The definition of "retail customer" in H.R. 4173 is more helpful in that it makes clear that the customer must be a natural person or his/her legal representative, and also provides that the personalized investment advice about securities must be used primarily for personal, family or household purposes. **H.R. 4173, § 7103(a) (p. 1278).**

a) Considerations

The SEC's evaluation would encompass SEC, Financial Industry Regulatory Authority ("FINRA"), state and other federal legal and regulatory standards.

The SEC would be directed to consider

(1) the SEC and FINRA regulatory, examination and enforcement resources devoted to enforcing the standards of care when broker-dealers and investment advisers provide personalized investment advice and

recommendations about securities to retail customers, including the frequency of examinations and length of time between examinations;

(2) the substantive differences, in detail, in the regulation of broker-dealers and investment advisers providing personalized investment advice to retail customers, including the relative amount of resources devoted by the SEC and FINRA;

(3) the specific instances in which either broker-dealer or investment adviser regulation and oversight are greater than the other;

(4) existing State securities and other regulators' legal or regulatory standards intended to protect retail customers;

(5) the potential impact, including with respect to access to services, on broker-dealers' retail customers if broker-dealers are subject to the standard of care or other requirements applied to investment advisers under the Investment Advisers Act of 1940;

(6) the potential impact of subjecting investment advisers to the SEC and FNRA standard of care applicable when broker-dealers make recommendations about securities to retail customers; and the oversight of one or more investment adviser self-regulatory organizations;

(7) the potential impact of eliminating the exclusion for brokers and dealers from the definition of "investment adviser" in the Investment Advisers Act of 1940, including any potential reduction on access to personalized investment advice and recommendations; the number of additional entitles and individuals that would be required to register under the Investment Advisers Act of 1940, additional requirements, including additional licensing registration and examination requirements for associated persons and their related costs, and the impact on SEC examination and enforcement resources;

(8) the ability of investors to understand differences in terms of regulatory oversight and examination between broker-dealers and investment advisers;

(9) the varying level of services, and their terms and scope, provided by broker-dealers and investment advisers to retail customers;

(10) any potential benefits or harms to retail investors that could result from any potential changes to regulatory requirements or legal standards, including any impact on protections from fraud; access to personalized investment advice and recommendations about securities; or the availability of such services;

(11) the additional costs and expenses to retail customers as well as to broker-dealers and investment advisers resulting from potential changes in the regulatory requirements or legal standards affecting broker-dealers,

investment advisers and their respective associated persons relating to obligations to retail customers; and

(12) any other considerations the SEC deems necessary and appropriate.

Senate Bill § 913(c) (pp. 940-946).

b) Report

The SEC's report of its study would be due to the Senate Banking Committee and the House Financial Services Committee one year from the enactment of the Act. In addition to discussing its analysis and findings, the SEC would be required to report on any additional statutory authority it would require to address any identifies gaps or overlaps. The SEC would be directed to see public comment in order to prepare its report. Within two years after the Act is enacted, the SEC would be required to commence any rulemaking needed to address any identified regulatory gaps or overlaps. **Senate Bill § 913(d)-(f) (pp. 946-948).** H.R. 4173 directs the SEC to facilitate (*i.e.*, either through direct rulemaking or by directing FINRA to adopt rules) simple and clear disclosures to investors regarding the terms of their relationships with broker-dealers and investment advisers, including any material conflicts of interest; and to example and promulgate any necessary rules, prohibiting or restricting certain sales practices, conflicts of interest and compensation schemes for broker-dealers and investment advisers if the SEC deems that certain practices are contrary to the public interest and the protection of investors. The SEC's enforcement authority with respect to broker-dealers and investment advisers would also be harmonized. **H.R. 4173, § 7103(a) (pp. 1280-1282).**

5. Other Studies

In addition to the study regarding the obligations of brokers, dealers and investment advisers, the Senate Bill would require other studies regarding financial literacy, mutual fund advertising, conflicts of interest, investor access to information on investment advisers and broker-dealers, and financial planners and the use of financial designations to be conducted, as detailed below. The reports on these studies would be due to the Senate Committee on Banking and the House Committee on Financial Services within one to two years of enactment of the Act.

a) Financial Literacy Among Investors

Under the Senate Bill, the SEC would be required to conduct a study to identify:

- the existing level of financial literacy among retail investors;
- methods to improve the timing, content, and format of disclosures to investors with respect to financial intermediaries, investment products, and investment services;
- the most useful and understandable relevant information that retail investors need to make informed financial decisions before engaging a financial intermediary or purchasing an investment product or service that is typically

sold to retail investors, including shares of open-end companies, as that term is defined in section 5 of the 1940 Act that are registered thereunder;

- methods to increase the transparency of expenses and conflicts of interests in transactions involving investment services and products, including shares of open-end companies described in the paragraph above;
- the most effective existing private and public efforts to educate investors; and
- in consultation with the Financial Literacy and Education Commission, a strategy to increase the financial literacy of investors.

The SEC's report would be due within two years of enactment of this section of the Senate Bill. **Senate Bill § 916 (pp. 962-964); H.R. 4173 § 7104 (pp. 1283-1284)** (requiring the SEC to publish a study focusing on retail customers).

b) Mutual Fund Advertising

Under the Senate Bill, the Comptroller would conduct a study on mutual fund advertising to identify:

- existing and proposed regulatory requirements for open-end investment company advertisements;
- current marketing practices for the sale of open-end investment company shares, including the use of past performance data, funds that have merged, and incubator funds;
- the impact of such advertising on consumers; and
- recommendations to improve investor protections in mutual fund advertising and additional information necessary to ensure that investors can make informed financial decisions when purchasing shares.

The Comptroller's report would be due within one year of enactment of this section of the Senate Bill. **Senate Bill § 917 (pp. 810-811).** The House Bill does not provide for a similar study.

c) Conflicts of Interest

The Senate Bill calls for the Comptroller to conduct a study to identify and examine potential conflicts of interest that exist between broker-dealers' investment banking and securities analyst functions and to make recommendation to Congress designed to protect investors from such conflicts. **Senate Bill § 919 (pp. 966-68).**

6. Improved Investor Access to Information on Investment Advisers and Broker-Dealers

Within six months of enactment of the Act, the Senate Bill would require the SEC to complete a study to improve investor access to disciplinary history and other registration information about current and previously registered brokers-dealers and investment advisers and their associated persons. Within 18 months of the completion of the study, the SEC would be required to implement any recommendations from the study. **Senate Bill § 919A (pp. 968-969).**

7. Financial Planners and the Use of Financial Designations

Within 180 days of the enactment of the Act, the Comptroller would be required to conduct a study on state and federal regulations to protect investors from misleading designations, the risks posed by the use of designations such as "financial advisor" and "financial consultant," and any legal or regulatory gaps in the regulation of financial planners and other individuals who provide financial planning services to consumers. The study report would need to include recommendations for the appropriate regulation of financial planners and other individuals who provide similar services. **Senate Bill § 919B (pp. 969-972).**

8. Point of Sale Disclosure

New paragraph (k) would be added to Exchange Act section 15 to provide the SEC with authority to issue rules designating documents or information that broker-dealers will have to provide to retail investors before they purchase an investment product or services. Any disclosure requirements will need to based on whether the rules will promote investor protection, efficiency competition, and capital formation. **Senate Bill § 918 (pp. 965-966).**

H.R. 4173 would authorize the SEC to promulgate rules in connection with implementing the fiduciary duty standard for broker-dealers and disclosure to retail customers, except that any rules related to disclosure prior to the purchase of investment products or services would have to wait until the SEC completes a study of disclosure to retail investors. That study would need to: (a) examine the nature of a "retail customer;" (b) the range of products and services sold or provided to retail customers and the sellers or providers of such products or services that are within the SEC's jurisdiction; (c) how such products and services are sold, the fees charged for them, and the conflicts of interest that may arise during the sales process of provision of services; (d) information that should be provided to retail customers and the appropriate person or entity to provide such information; and (e) ways to ensure that reasonably similar products and services are subject to similar regulatory treatment. **H.R. 4173 § 7104 (pp. 1283-1285).**

B. Increasing Regulatory Enforcement and Remedies

1. Mandatory Pre-dispute Arbitration Provisions

Section 15 of the Exchange Act would be amended to provide the SEC with rulemaking authority to reaffirm, to prohibit, or to impose conditions or limitations on broker-dealers and municipal securities dealers' use of mandatory pre-dispute provision in client or customer agreements. A parallel amendment would be made to Section 205 of the Advisers Act. **Senate Bill § 921 (pp. 972-974).**

2. Whistleblower Protection

The Senate Bill provides that a whistleblower who voluntarily provides information to the SEC that leads to a successful enforcement action resulting in over $1,000,000 of monetary sanctions shall be awarded by the SEC an amount not less than 10% and not more than 30% of the monetary sanctions. **Senate Bill § 922 (pp. 974-990).** The House Bill would provide for a similar award, but would not set a minimum award amount. **H.R. 4173 § 7203(a) (pp. 1294-1295).** Both bills state that determination of the amount of the award shall be in the discretion of the SEC and subject to certain prescribed criteria. **Senate Bill § 922(c) (pp. 977-979); H.R. 4173 § 7203(a) (pp. 1295-1296).** The Senate Bill would allow a whistleblower to appeal a determination regarding an award, while the House Bill states that any such determinations shall be final and not subject to judicial review. **Senate Bill § 922(f) (p. 980); H.R. 4173 § 7203(a) (p. 1297).** Both bills prohibit awards paid to various whistleblowers, including, but not limited to, people who work for certain regulatory or law enforcement entities, people who obtain information through performance of a financial audit required by the securities laws or people who are convicted of a criminal violation related to the action for which the information was provided. **Senate Bill § 922(c)(2) (pp. 978-979); H.R. 4173 § 7203(a) (pp. 1295-1296).**

Both bills would require that a Securities and Exchange Commission Investor Protection Fund be established by the Treasury of the United States out of which whistleblower awards would be paid. Both bills contain similar provisions with respect to deposits and credits and the manner in which money in the fund can be invested. The main difference between the Senate and the House bills is that, under the Senate Bill, the fund would be capped at $200,000,000 and could also be used to fund certain activities of the Inspector General of the SEC; whereas, under the House Bill, the fund would be capped at $100,000,000 and could also be used to fund investor education programs. **Senate Bill § 922(g) (pp. 980-982); H.R. 4173 § 7203(a) (pp. 1297-1301).**

Both bills would prohibit employers from discharging or otherwise discriminating against employees or contractors because of any lawful act done to provide the SEC with information in accordance with this section or to assist in an investigation or action by the SEC based on such information. An individual alleging discharge or other discrimination in violation of this section would be allowed to bring suit in the appropriate district court within 6 years of the violation or within 3 years of discovering the violation, but in no event later than 10 years after the violation. An employee or contractor who prevails in such an action would be entitled to reinstatement, two times the amount of back pay, and litigation costs and attorneys fees. **Senate Bill § 922(h) (p. 983-990); H.R. 4173 § 7203(a) (pp. 1301-1304).** The Senate Bill would also extend whistleblower protections to employees of nationally recognized statistical rating organizations. **Senate Bill § 922 (as amended by S.AMDT. 3840) (p. 990).**

Under the both bills, all information provided to the SEC by a whistleblower would be confidential and privileged, although disclosure could be made to certain government agencies if such disclosure is necessary to enable other regulatory entities to accomplish the purposes of the Exchange Act. **Senate Bill § 922 (986-987); H.R. 4173 § 7203(a) (p. 1303-1305).** The House Bill would also prohibit disclosure of any other information that could reasonably be expected to reveal the identity of the whistleblower. **H.R. 4173 § 7203(a) (p. 1303).**

Both bills contain various conforming amendments to the securities laws, mostly related to imposition of monetary sanctions. **Senate Bill § 923 (pp. 990-991); H.R. 4173 § 7204 (pp. 1307-1308).** The bills anticipate implementing regulations related to whistleblower incentives and protection and they require these be enacted within 270 days of enactment. **Senate Bill § 924 (pp. 992-993); H.R. 4173 § 7205 (pp. 1308-1309).**

3. Collateral Bars

Both bills would expand the SEC's enforcement authority by giving it the authority, upon a determination that a person violated a federal securities law, to bar that person from associating with persons involved in all aspects of the financial services industry, regardless of the area of the financial services industry in which the violation occurred. Specifically, under both bills, sections 15(b)(6)(A), 15B(c)(4), and 17A(c)(4)(C) of the Exchange Act of 1934 and section 203(f) of the Investment Advisers Act of 1940, which permit the SEC to bar a violator from association with a "broker or dealer", "municipal securities dealer", "transfer agent" or "investment adviser", respectively, would be amended to allow the SEC to bar association with a "broker, dealer, investment adviser, municipal securities dealer, transfer agent, municipal adviser, or nationally recognized statistical rating organization" in each case. **Senate Bill § 925 (pp. 993-994); H.R. 4173 § 7206 (pp. 1309-1311).**

4. Disqualifying Felons and Other "Bad Actors" From Regulation D Offerings

Within one year after the Act's enactment, Section 926 of the Senate Bill would require the SEC to issue rules for the disqualification of offerings and sales of securities made under Rule 506 of Regulation D of the Securities Act of 1933 that disqualify any offer or sale of securities by certain felons and other "bad actors".

The SEC's rules would be required to include disqualification provisions substantially similar to those found in Rule 262 of Regulation A of the Securities Act of 1933. The rules would also be required to disqualify any offering or sale of securities by a person that is subject to a final order of a state securities, banking, insurance or similar regulator, a Federal banking agency or the National Credit Union Administration, that (i) bars the person from (a) association with an entity regulated by such regulator, (b) engaging in the business of securities, insurance, or banking, or (c) engaging in savings association or credit union activities; or (ii) constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within the 10-year period ending on the date of the filing of the offer or sale. The rules also would be required to disqualify any offering or sale of securities by a person convicted of a felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the SEC. Senate Bill § 926 (**pp. 994-996)** as amended by S.AMDT. 4056).Streamlining of Filing Procedures for Self-Regulatory Organizations

Section 19(b) of the Exchange Act would be amended to essentially require the SEC to institute or conclude self-regulatory organization's rule change proceedings. **Senate Bill § 915 (pp. 954-962).** The corollary section of H.R. 4713 ostensibly includes no substantive change to Section 19(b), except to extend its scope from "exchanges" to "self-regulatory organizations." **H.R. 4713 § 7404 (p. 1351).**

C. Improvements to the Regulation of Credit Agencies

1. Enhanced Regulation, Accountability, and Transparency of Credit Rating Agencies

Subtitle C of Title IX of the Senate Bill seeks to impose increased accountability on credit rating agencies ("CRAs") due to findings that, among other things, individual and institutional investors and financial regulators rely on credit ratings; notwithstanding that CRAs do not as a general matter have individual investors as their direct clients, and CRAs, including those that are not nationally recognized statistical rating organizations ("NRSROs"), act as gatekeepers in the debt markets akin to securities analysts and auditors. On those bases, Senator Dodd seeks to impose similar levels of public oversight and accountability on CRAs, and similar standards of liability and oversight as applicable to auditors, securities analysts and investment bankers. Section 15E of the Securities Exchange Act o 1934 would be amended to specifically state that, "[n]othing in this paragraph may be construed to afford a defense against any action or proceeding brought by the Commission to enforce the antifraud provisions of the securities laws." The Senate Bill particularly references CRAs' role advising arrangers of structured financial products on potential ratings of such products, the inaccuracy of ratings on such securities, and references the need for their conflicts of interest to be monitored carefully. **Senate Bill § 931 (pp. 998-1057).**

Unlike the House's draft Accountability, Reliability, and Transparency in Rating Agencies Act (the "ARTRAA"), the Senate Bill would not require CRAs that provide credit ratings to issuers of securities for a fee, or that are otherwise exempt, to register as an NRSRO. Instead, the Bill would retain the current system of allowing CRAs to elect whether to become NRSROs. **H.R. 4173 § 6002(a)(1) (pp. 1218-1219).** The House Bill would replace the term "nationally recognized statistical rating" every time it appears in the Securities Act of 1933 and the Securities Exchange Act of 1934, with the term "nationally *registered* statistical rating." **H.R. 4173 § 6005 (p. 1254).**

a) Internal Controls Over Processes for Determining Credit Ratings

Both bills would require each NRSRO to establish, maintain, enforce, and document effective internal controls governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings. **Senate Bill § 932 (p. 1001); H.R. 4173 § 6002(a)(11) (p. 1241).** Under the Senate Bill, each NRSRO would be required to submit to the SEC an annual internal controls report, attested to by the chief executive officer or equivalent individual, that contains an explanation of the responsibility of management in establishing and maintaining effective internal controls and an assessment of the effectiveness of the internal control structure. **Senate Bill § 932 (pp. 1001-1002).** Under the House Bill, the compliance officer would be charged with certifying and submitting to the SEC a similar report. **H.R. 4173 § 6002 (p. 1237).**

b) Board of Directors

The Senate Bill would require NRSROs to have a board of directors. At least half, but no fewer than two, of the members of the board would be required to be independent of the NRSRO, and a portion of the directors would have to include users of ratings. In order to be deemed "independent," the director could not accept any consulting, advisory or other compensatory fee from the NRSRO, other than a director's fee, or be an associated person of an NRSRO or any of its affiliated companies. An independent director would be disqualified from any deliberation involving a specific rating in which the board member has a financial interest in the outcome. Independent directors' compensation could d not be linked to the business performance of the NRSRO and would have to be arranged to sure the directors' independent judgment. The term of office of the independent directors would be limited to a non-renewable, pre-agreed fixed period not exceeding 5 years.

The board of directors would be responsible for overseeing the establishment, maintenance and enforcement of policies and procedures for determining credit ratings, and addressing, managing and disclosing conflicts of interest. The board would also have responsibility for the effectiveness of the NRSRO's internal control system with respect to its policies and procedures for determining ratings, and the compensation and promotion practices of the NRSRO. **Senate Bill § 932 (pp. 1023-1024).** The House Bill would impose similar requirements, but would only require that one third of the members of the board be independent. **H.R. 4173 § 6002 (pp. 1226-1227).**

The Senate Bill would provide that if an NRSRO is a subsidiary, the board of its parent entity would be able to satisfy these requirements by assigning the duties just discussed to a committee if one-half of the committee's members are independent and one committee member is a user of ratings. The Senate Bill would also give the SEC the ability to excuse small NRSROs from the rules regarding NRSRO boards if a special committee is put in place. **Senate Bill § 932 (pp. 1024-1025).** No similar provisions are found in the House Bill.

c) Penalties for Certain Actions

The Senate Bill would give the SEC authority to impose fines for misconduct and would expand the misconduct to which penalties apply to include failure to reasonably supervise an individual who violates the securities laws. **Senate Bill § 932 (pp. 1002-1003).** The SEC would also be required to adopt rules establishing fines and other penalties for NRSROs who violate the new NRSRO rules and requirements. **Senate Bill § 932 (p. 1002).**

The House Bill would make these same changes, but would also provide that penalties may be imposed on any person associated or seeking to become associated with an NRSRO or any person who was associated with an NRSRO at the time of the alleged misconduct. Additionally, the House Bill would allow a penalty to be imposed if a person or NRSRO fails to conduct sufficient surveillance to ensure that credit ratings remain current. **H.R. 4173 § 6002 (pp. 1222-1225).**

d) Suspension or Revocation for Particular Class of Securities

Both bills would allow the SEC to temporarily suspend or permanently revoke the registration of an NRSRO with respect to a particular class of securities, if it determines that, after notice and the opportunity for a hearing, the NRSRO lacks the financial and managerial expertise to consistently produce credit ratings with integrity. **Senate Bill § 932 (pp. 1003-1004); H.R. 4173 § 6002 (pp. 1222-1225).**

e) Conflicts of Interest – Separation of Ratings from Sales and Marketing

The Senate Bill would require the SEC to issue rules to prevent the sales and marketing considerations of an NRSRO from influencing ratings. If appropriate, such rules could provide an exception for small NRSROs. The rules must also provide for suspension or revocation of registration if it is determined, after notice and an opportunity for a hearing, that a violation of a rule by an NRSRO has affected a rating. **Senate Bill § 932 (pp. 1004-1007).**

Within 180 days of enactment of the ARTRAA, H.R. 4173 would strictly prohibit an NRSRO, any of its affiliates, or any person associated with such organization that provides a credit rating for an issuer, underwriter, or placement agent of a security from providing any non-rating service to that issuer, underwriter or placement agent. **H.R. 4173 § 6002 (p.1251).** There would also be a one-year look-back period regarding potential conflicts of interest of former NRSRO employees who leave for an issuer, underwriter, or sponsor of a security subject to a rating by the NRSRO. **H.R. 4173 § 6002 (pp. 1231-1234).**

f) Limitations on and Duties of Compliance Officer

The Senate Bill would prohibit a compliance officer of an NRSRO from performing credit ratings, participating in the development of ratings methodologies or models, performing any sales or marketing functions, or participating in the establishment of compensation levels, other than for compliance personnel. The compliance officer would be required to establish procedures for the receipt, retention and treatment of complaints regarding credit ratings. The compliance officer must also submit to the NRSRO an annual report on compliance with securities laws and the policies and procedures of the NRSRO. The NRSRO must submit this annual report to the SEC, together with the chief executive officer's certification. **Senate Bill § 932 (pp. 1005-1006).**

The House Bill would impose similar limitations and duties on compliance officers of NRSROs. Among other things, it also would require compliance officers to report directly to the board of directors of the NRSRO, review compliance with policies and procedures relating to conflicts of interest and internal controls, and resolve any conflicts of interest. **H.R. 4173 § 6002) (pp. 1234-1237).**

g) SEC Regulation of NRSROs

The Senate Bill would require the SEC to establish an Office of Credit Ratings to administer the rules of the SEC with respect to NRSROs, promote accuracy in credit ratings and

ensure that ratings are not unduly influenced by conflicts of interest. The Director of the Office of Credit Ratings would report to the SEC's Chairman, and the office would be required to be staffed by persons with knowledge of and expertise in corporate, municipal, and structured debt finance.

The Office of Credit Ratings would be required to conduct, at least annually, examinations of each NRSRO to determine (i) whether the NRSRO conducts business in accordance with its policies, procedures, and rating methodologies; (ii) the management of conflicts of interest; (iii) the implementation of ethics policies; (iv) the internal supervisory controls; (v) the governance of the NRSRO; (vi) the activities of the compliance officer; (vii) the handling of complaints; and (viii) the policies of the NRSRO governing the post-employment activities of its former staff. The SEC would be required to make the findings of these examinations available to the public. **Senate Bill § 932 (pp. 1008-1011).** Similarly, the House Bill would require the SEC to establish an office to administer the rules of the SEC with respect to NRSROs. **H.R. 4173 § 6002 (pp. 1238-1239).**

h) Transparency of Ratings Performance

Both bills would require the SEC to establish rules requiring NRSROs to disclose information on initial credit ratings and any subsequent changes for the purpose of facilitating the assessment of the accuracy of ratings and the comparison of ratings by different NRSROs. Similar to requirements relating to investment banks' research, the required disclosures would be required to be comparable among NRSROs, clear and informative for investors, and made freely available. **Senate Bill § 932 (pp. 1011-1013); H.R. 4173 § 6002 (pp. 1239-1241).** The Senate Bill would also require that the disclosure be appropriate to the business model of the NRSRO, and that it include performance information over a range of years and for a variety of types of credit ratings, including ratings withdrawn by the NRSRO. **Senate Bill § 932 (p. 1013).**

The House Bill would require the SEC to adopt rules, within 180 days of enactment of the ARTRAA, to require that NRSROs publish on their websites a random sample of rating histories and that they also be provided to the SEC in a format consistent with SEC publication on the EDGAR system. **H.R. 4173 § 6011 (p. 1263).**

i) Credit Ratings Methodologies

The Senate and House Bills would require the SEC to prescribe rules with respect to the procedures and methodologies used by NRSROs, including qualitative and quantitative data and models. The rules would need to ensure that credit ratings are determined using procedures and methodologies that have been approved by the board of directors or senior credit officer of the NRSRO and that are in accordance with the NRSRO's policies and procedures for the development of credit rating procedures and methodologies. The rules would also be required to ensure that when material changes are made to the credit rating procedures and methodologies, the reason for the change is publicly disclosed and the changes are applied consistently to all ratings and within a reasonable time. Any changes to surveillance procedures would need to be applied to then current credit ratings within a reasonable period of time. The rules would also have to be designed to notify users of credit ratings of the version of a procedure or methodology used with respect to a rating, when a material change is made to a procedure or methodology, the

likelihood that it will affect current ratings, and when a significant error is identified in procedure or methodology. **Senate Bill § 932 (pp. 1013-1015); H.R. 4173 § 6002 (pp. 1241-1243).**

j) Transparency of Credit Rating Methodologies and Information Reviewed

The Senate Bill would mandate that the SEC require NRSROs to accompany each credit rating with a form disclosing assumptions underlying the rating procedures and methodologies, data relied on to determine ratings, use of servicer or remittance reports in conducting surveillance of the rating, if applicable, and any other information that can help users of credit ratings better understand credit ratings in each class of rating issued. The form would need to be easy to use, made readily available and present quantitative information in a manner that is directly comparable across types of securities.

Each NRSRO would be required to disclose qualitative and quantitative information on its form. The qualitative information disclosed would need to include (i) the credit ratings produced by the NRSRO, (ii) the main assumptions and principles used in constructing procedures and methodologies, (iii) the potential limitations of credit ratings, information on the uncertainty of credit ratings, (iv) whether and to what extent third party due diligence services have been used, (v) a description of data relied upon, (vi) a statement containing an assessment of the quality of information available and considered in producing a rating in relation to the quality of information available in rating similar issuances, (vii) information relating to conflicts of interest and (viii) any additional information required by the SEC. The required quantitative information would be required to include an explanation or measure of the potential volatility of the credit rating, information on the historical performance of the rating, information on the expected probability of default and the expected loss in the event of default, information on the sensitivity of the rating to assumptions made by the NRSRO, and such additional information required by the SEC. **Senate Bill § 932 (pp. 1015-1021).**

H.R. 4173 would require the SEC to adopt similar rules with respect to the transparency of credit rating methodologies and information reviewed, but would gives the SEC more specific guidance on the content of such rules. It also would require each NRSRO to certify that the information disclosed in connection with ratings issued is true and accurate. **H.R. 4173 § 6002 (pp. 1245-1249).**

k) Due Diligence Services for Asset-Backed Securities

Both bills would require the issuer or underwriter of any asset-backed security to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter. Any third-party providing due diligence services would also be required to provide the NRSRO that produces any rating to which the services relate a certification that a thorough review of data, documentation, and other relevant information has been conducted. The SEC would be required to adopt rules requiring NRSROs to publicly disclose this certification at the time related ratings are issued. **Senate Bill § 932 (pp 1020-1022; H.R. 4173 § 6002 (pp. 1249-1251).**

2. Enforcement and Penalties; State of Mind in Private Actions

The Senate Bill would provide that the enforcement and penalty provisions of the Exchange Act would apply to statements made by NRSROs in the same manner and to the same extent as such provisions apply to statements made by a registered public accounting firm or a security analyst under the securities laws. **Senate Bill § 933 (pp. 1025-1027).** Similarly, H.R. 4173l would provide that, in any private action against an NRSRO under the securities laws, the pleading standards would be the same as those applicable to any other person in the same private right of action. **H.R. 4173 § 6003(b) (pp. 1252-1253).**

Both bills would provide that statements made by NRSROs would not be deemed forward-looking statements for purposes of the safe-harbor provided by Exchange Act section 21E. **Senate Bill § 933 (pp. 1025); H.R. 4173 § 6003 (pp. 1252-1253).**

The Senate Bill would change the state of mind requirement for private securities actions brought against a credit rating for money damages. Under the new requirement it would be sufficient that the complaint state with particularity facts giving rise to a strong inference that the credit agency knowingly or recklessly failed either to conduct a reasonable investigation of the rated security with respect to the factual elements relied upon by its own methodology for evaluating credit risk, or failed to obtain reasonable verification of such factual elements from other sources that the credit agency considers to be competent and that were independent of the issuer and underwriter. The verification could be based on a sampling technique that does not rise to the level of an audit. **Senate Bill § 933 (pp. 1026-1027).**

Under the House Bill a complaint would satisfy the state of mind element if it states with particularity facts giving rise to a strong inference that the NRSRO was grossly negligent in violating the securities laws. **H.R. 4173 § 6003 (p. 1252).** The House Bill also includes a provision that would nullify Rule 436(g) under the Securities Act, which would have the effect of potentially subjecting NRSROs to Securities Act liability because ratings of NRSROs could be considered part of the registration statement for the relevant rated securities. **H.R. 4173 § 6012 (p. 1264).**

3. Referring Tips to Law Enforcement or Regulatory Authorities

The Senate Bill would require NRSROs to report to law enforcement or regulatory authorities any credible information it receives from a third party that alleges that an issuer of a security that it rates has committed or is committing a material violation of law. **Senate Bill § 934 (pp. 1027-1028).** The House Bill does not include a similar provision.

4. Consideration of Information from Sources Other Than the Issuer

The Senate Bill would require each NRSRO to consider in producing a rating any information that it has or receives from sources other than the issuer that it finds credible and potentially significant to a rating decision. **Senate Bill § 935 (p. 1028).** The House Bill does not include a similar provision.

5. Qualification Standards for Credit Ratings Analysts

Within one year of enactment of the ARTRAA, the Senate Bill would require the SEC to issue rules reasonably designed to ensure that any person employed by an NRSRO to perform credit ratings meets standards of training, experience and competence necessary to produce accurate ratings and is tested for knowledge of the credit rating process. **Senate BillS. § 936 (pp. 1028-1029).** The House Bill does not include a similar provision.

6. Timing of Regulations

Under both bills, unless otherwise specified, within one year of enactment of the ARTRAA, the SEC would be required to issue all required final regulations. **Senate Bill § 937 (p. 1029); H.R. 4173 § 6006 (p. 1254).**

7. Universal Ratings Symbols

Both bills would require the SEC to issue rules requiring NRSROs to establish, maintain, and enforce written policies and procedures that clearly define and disclose the meaning of any symbol used by the NRSRO to denote a credit rating and that apply any symbols consistently for all types of instruments for which the symbol is used. NRSROs would still be permitted to use distinct sets of symbols to denote credit ratings for different types of instruments. **Senate Bill § 938 (pp. 1029-1030); H.R. 4173 § 6002 (pp. 1243-1245).** The House Bill would require that within 180 days of enactment of the ARTRAA, the SEC

The House Bill would also authorize the SEC to prescribe rules requiring NRSROs to establish credit rating symbols to distinguish ratings for structured products from ratings for other products. **H.R. 4173 § 6002 (p. 1243).**

Both bills would also require the SEC to prescribe rules requiring NRSROs to establish, maintain, and enforce written policies and procedures that assess the probability than an issuer of an instrument will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the instrument. **Senate Bill § 938 (p. 1029-1030); H.R. 4173 § 6002 (pp. 1243-1244).**

8. Various Studies

a) Statutory References to Credit Ratings

The Senate Bill would remove a number of statutory references to credit rating agencies and NRSROs and require the responsible governmental agencies to establish alternative standards of credit-worthiness. The amendments made by the Senate Bill would take effect two years after enactment of this Act. **Senate Bill § 939 (pp. 1030-1037) (as amended by S.AMDT. 3774).**

Specifically, the Senate Bill would amend section 7(b)(1)(E)(i) of the Federal Deposit Insurance Act by replacing the term "credit rating entities" with the term "credit analysts" in the list of sources that can be consulted by the Federal Deposit Insurance Corporation ("FDIC") when conducting risk-based assessments of depository institutions. The Senate Bill would also

replace the requirement in section 28(d) of the Federal Deposit Insurance Act, which prohibits savings institutions from owning corporate debt securities that are "not of investment grade," with a requirement that the securities owned meet "standards of credit-worthiness as established by the [FDIC]." The Senate Bill would also amend the provisions found in section 28(e) of the Federal Deposit Insurance Act, which relate to transfer of corporate debt securities not of investment grade, by replacing the term, "not of investment grade," with the phrase, "that does not meet standards of credit-worthiness established by the [FDIC]." **Senate Bill § 939(a) (pp. 1030-1031) (as amended by S.AMDT. 3774).**

The Senate Bill would amend the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, which currently allows the director of the Federal Housing Finance Agency to contract with any NRSRO to conduct a review of Fannie Mae, Freddie Mac and the Federal Home Loan Banks, to state that any entity can be contracted with for that purpose. **Senate Bill § 939(b) (p. 1032) (as amended by S.AMDT. 3774).**

The Senate Bill would amend the exemption found in section 6(a)(5)(A)(iv)(I) of the Investment Company Act of 1940, which is currently conditioned on not purchasing certain securities if they are not rated investment grade by at least one NRSRO, to state that the purchased securities must meet "such standards of credit-worthiness as the [SEC] shall adopt." **Senate Bill § 939(c) (p. 1032) (as amended by S.AMDT. 3774).**

The Senate Bill would amend subsection (a)(2)(E) of section 5136A of title LXII of the Revised Statutes, which sets forth the conditions that must be met for national banks to be able to control financial subsidiaries, by replacing the condition that a national bank meet "applicable rating [requirements]", with the condition that the national bank meet "standards of credit-worthiness established by the Comptroller of the Currency." Similar amendments would be made in subsections (a)(3), (f) and (f)(1). **Senate Bill § 939(d) (pp. 1032-1033) (as amended by S.AMDT. 3774).**

The Senate Bill would amend paragraphs (41) and (53)(A) of section 3(a) of the Securities Exchange Act of 1934, which define "mortgage related security" and "small business related security", respectively, by striking references to investment grade rating categories used by NRSROs and replacing them with the phrase "meets standards of credit-worthiness as established by the [SEC]." **Senate Bill § 939(e) (p. 1034) (as amended by S.AMDT. 3774).**

The Senate Bill would amend 22 U.S.C. § 286hh(a)(6) by replacing the term "credit rating" with the term "credit-worthiness." Currently, 22 U.S.C. § 286hh requires the Secretary of the Treasury to instruct the U.S. Executive Director of the International Bank for Reconstruction and Development to initiate discussions with other directors of such bank and to advocate and support the facilitation of voluntary market-based programs for the reduction of sovereign debt and the promotion of sustainable economic development, which, if implemented, would, among other things, "involve such bank in lending for purposes of debt reduction and conversion only where such involvement would not lower the credit rating of such bank." **Senate Bill § 939(f) (p. 1034) (as amended by S.AMDT. 3774).**

Similarly, the House Bill would directly replace numerous statutory references to credit ratings with alternative standards of credit worthiness. Under the House Bill, the Comptroller

and various Federal agencies would be required to review other regulations and remove references to credit ratings and to replace them with standards of credit worthiness that each agency would be required to establish as appropriate. **H.R. 4173 § 6090, 6010 (pp. 1256-1261).**

b) Strengthening NRSRO Independence

The Senate Bill would require the SEC to study and to report to the Senate Banking Committee and the House Financial Services Committee on the independence of NRSROs and how that independence affects their ratings. In conducting the study, the SEC would be required to evaluate the management of conflicts of interest raised by providing non-rating services, the potential impact of rules prohibiting NRSROs from providing non-rating services, and any other issues the SEC's Chairman determines are appropriate. **Senate Bill § 939A (pp. 1035-1037).**

c) GAO Study on Alternative Business Models for Compensating NRSROs

Both Bills would require the Comptroller General to study and to report to the Senate Banking Committee and the House Financial Services Committee within one year on alternative means for compensating NRSROs in order to create incentives for NRSROs to provide more accurate credit ratings, including any statutory changes that would be required. **Senate Bill § 939B (p. 1037); H.R. 4173 § 6013 (p. 1264-1271).**

d) GAO Study on the Creation of an Independent Professional Analyst Organization

The Senate Bill would require the Comptroller to study and to report to the Senate Banking Committee and the House Financial Services Committee on the feasibility and merits of creating an independent professional organization for rating analysts employed by NRSROs that would be responsible for establishing independent standards for governing the profession, establishing a code of ethics, and overseeing the profession. **Senate Bill § 939C (p. 1038).** The House corollary is a Similarly, the House Bill would call for the creation of a Credit Ratings Agency Advisory Board. **H.R. 4173 § 6008 (pp. 1255-1256).**

e) Initial Credit Rating Assignments

The Senate Bill would dramatically change the way initial credit ratings are issued for structured finance products. Section 15E of the Securities Exchange Act of 1934 would be amended to include subsection (w), relating to "Initial Credit Rating Assignments". According to the Senate Bill, the term "structured finance product" includes any asset backed security and any structured product based on an asset backed security, but is subject to further definition and expansion by the SEC. **Senate Bill § 939D (pp. 1038-1057). (Section 939D was added by S.AMDT. 3991).)**

9. Credit Rating Agency Board

The Senate Bill would require the SEC to establish the Credit Rating Agency Board ("CRA Board"), a self-regulatory organization tasked with assigning qualified NRSROs to provide initial credit ratings on structured finance products. The SEC would be required to select

initial members of the CRA Board and establish a schedule to ensure that the CRA Board begins assigning qualified NRSROs to provide initial ratings not later than one year after selection of the members of the CRA Board, which is required to be completed within 180 days after enactment of this Act. The schedule must also indicate when (i) the CRA Board will conduct a study of the securitization and ratings process and provide recommendations to the SEC; (ii) the SEC will issue the rules and regulations required under this section; (iii) the CRA Board is permitted to issue related rules; and (iv) the CRA Board will begin the process of selecting qualified NRSROs and assigning them to provide initial ratings.

The CRA Board would initially be composed of an odd number of members selected from the industry. A majority of the members would be representatives of the investor industry who do not represent issuers. The CRA Board must also consist of a representative of the issuer industry, a representative of the credit rating agency industry, and an independent member. The members' initial term would last four years. Prior to the expiration of the initial terms, the SEC would be required to establish fair procedures for the election of future members and would be permitted to increase the size of the CRA Board or the length of future terms, but would not be allowed to alter the basic composition rules described above. The SEC would also be permitted to issue further rules and regulations concerning composition and responsibilities of the CRA Board and would be authorized to regulate the activities of the CRA Board.

The CRA Board would have authority to fund its expenses by levying fees from qualified NRSRO applicants and periodically from qualified NRSROs. **Senate Bill § 939D (pp. 1039-1045).**

10. Qualified NRSROs

To become a qualified NRSRO with respect to a category of structured finance products, an NRSRO would be required to submit an application to the CRA Board. The application would include (i) information regarding the institutional and technical capacity of the NRSRO to issue credit ratings; (ii) information on whether the NRSRO has been exempted by the SEC from any requirements under any other provision section 15E of the Securities Exchange Act of 1934; and (iii) any other information the CRA Board may require. The CRA Board would be permitted to reject the application of an NRSRO that has been exempted by the SEC from any requirements under section 15E of the Securities Exchange Act of 1934.

Based on the applications submitted by NRSROs, the CRA Board would select qualified NRSROs with respect to each category of structured finance products. The specific categories are not defined by the Senate Bill, but would be required to be defined by the SEC. **Senate Bill § 939D (pp. 1045-1047).**

11. Assignment Process for Initial Credit Ratings

Under the changes required by the Senate Bill, an issuer that seeks an initial credit rating for a structured finance products would not be allowed to request an initial rating from an NRSRO, but would be required to submit a request for an initial rating to the CRA Board. The CRA Board would be required to assigned a qualified NRSRO to provide an initial credit rating for each request received. **Senate Bill § 939D (p. 1047).**

The Senate Bill would require the CRA Board to evaluate a number of selection methods, including a lottery or rotating assignment system to reduce the conflicts of interest that exist under the issuer-pays model. In evaluating a selection method, the CRA Board would be required to consider (i) information submitted by the qualified NRSRO regarding its institutional and technical capacity to issue ratings, (ii) the CRA Board evaluations (discussed below), and (iii) formal feedback from institutional investors. The CRA Board would also be required to implement a mechanism to increase or decrease assignments based on past performance. After evaluating the methods, the CRA Board would prescribe and publish the selection method to be used. The CRA Board would be prohibited from choosing a selection method that would allow for solicitation or consideration of the preferred nationally recognized statistical rating organizations of the issuer. The CRA Board would be required to issue rules explaining the process by which it can modify the selection process. **Senate Bill § 939D (pp. 1047—1050).**

A qualified NRSRO selected to issue an initial credit rating is permitted to refuse to accept the selection by notifying the CRA Board of its refusal and submitting a written explanation of the refusal. These written explanations must be submitted by the CRA Board to the SEC and must be included in the annual inspection reports compiled by the Office of Credit Ratings described above. If the selected NRSRO refuses to accept the selection, the CRA Board would be required to select another qualified NRSRO. **Senate Bill § 939D (pp. 1049-1050).**

All initial credit ratings issued under these provisions would be required to include the following disclaimer: "This initial rating has not been evaluated, approved, or certified by the Government of the United States or by a Federal agency." **Senate Bill § 939D (pp. 1047—1050).**

Qualified NRSROs selected to provide an initial credit ratings are permitted to charge a reasonable fee, as determined by the SEC. Fees can be determined by the qualified NRSROs, unless the CRA Board determines that it is necessary to issue rules on fees. **Senate Bill § 939D (p. 1052).**

12. Additional Regulations and Provisions

The Senate Bill would allow, but not require, the CRA Board to issue regulations requiring an issuer that has received an initial credit rating to request a revised initial credit rating, using the same assignment method explained above, each time the issuer experiences a material change in circumstances, as defined by the CRA Board. **Senate Bill § 939D (pp. 1054).**

The Senate Bill would not prohibit an issuer from requesting and receiving additional ratings with respect to a debt security, if the initial rating was provided in accordance with these provisions. **Senate Bill § 939D (pp. 1052).** Moreover, nothing in the Senate Bill would prohibit an NRSRO from independently providing a credit rating with respect to a debt security if the NRSRO does not enter into a contract with the issuer of the debt security to provide the initial credit rating and is not paid by the issuer to provide the initial credit rating. **Senate Bill § 939D (pp. 1053).**

Any public communications by the issuer with respect to the credit rating of a debt security would be required to specify whether the credit rating was made by a qualified NRSRO

selected by the CRA Board in accordance with these provisions or by an NRSRO not so selected. The Senate Bill specifically makes it unlawful to misrepresent any subsequent credit rating provided for a debt security as an initial credit rating provided by a qualified NRSRO. **Senate Bill § 939D (pp. 1053--1054).**

13. Performance Evaluations of Qualified NRSROs

The Senate Bill would require the CRA Board to prescribe rules by which it will evaluate the performance of each qualified NRSRO. At a minimum, the rules must require an annual evaluation of each qualified NRSRO. In conducting an evaluation, the CRA Board would be required to consider (i) the annual examination conducted by the Office of Credit Ratings; (ii) surveillance of the credit ratings conducted by the qualified NRSRO after the ratings are issued including how the rated instruments perform, the accuracy of the ratings, and the effectiveness of the methodologies used by the qualified NRSRO; and (iii) any other factors the CRA Board deems relevant. The results of these performance evaluations must be made available to Congress by the CRA Board. **Senate Bill § 939D (pp. 1050-1052).**

14. Conflicts Rules

The Senate Bill would also add provisions designed to avoid conflict with respect to the issuance of credit ratings. CRA Board members and employees would not be permitted to accept any loan of money or securities or anything above nominal value from any NRSRO, issuer or investor, except that disclosed, routine banking and brokerage loans or loans that are clearly motivated by a personal or family relationship would be permitted. CRA Board members and employees would also be prohibited from engaging in employment negotiations with any NRSRO, issuer or investor unless the member or employee discloses the negotiations and recuses himself from all proceedings concerning the entity in question until termination of the negotiations or of his employment with the CRA Board. Under the conflict provisions, credit analysts of a qualified NRSRO would be prohibited from accepting any loan of money or securities or anything above nominal value, from any issuer or investor, except that disclosed, routine banking and brokerage loans or loans motivated by a personal or family relationship would be permitted. **Senate Bill § 939D (pp. 1054-1056).**

15. Report

The Senate Bill would require the SEC to submit to Congress a report with recommendations concerning continuation of the CRA Board, modification of the CRA Board's procedures and modifications to the provisions of this subsection, within five years after the CRA Board begins assigning initial ratings. **S.3217 § 939D (p. 1056-1057).**

D. Accountability and Executive Compensation

Subtitle E of Title IX contains executive compensation reforms aimed at all public companies, and amends certain provisions of the Securities Exchange Act of 1934, as amended, (the "Exchange Act") (15 U.S.C. § 78a et seq.) to impose certain substantive requirements and enhance disclosure obligations related to compensation practices. In addition, a provision in the subtitle also amends BHC Act § 5 to prohibit "excessive compensation" at bank holding companies. Please see our client alert (available here [insert hyperlink]) for a more detailed

description of both the executive compensation and corporate governance provisions of the Senate Bill (summarized in Section E below) applicable to public companies as well as the practical implications of these provisions.

1. Shareholder Vote on Executive Compensation Disclosures

Section 951 of the Senate Bill would amend Section 14 of the Exchange Act (15 U.S.C. § 78n) by adding a new subsection that would require shareholders to vote annually to approve the compensation of named executive officers as disclosed pursuant to the executive compensation requirements of Item 402 of Regulation S-K (§ 229.402 of Title 17, Code of Federal Regulations). The shareholder vote will not be binding on the issuer or board of directors. This "say on pay" provision would be applicable to meetings occurring six months after enactment. Unlike H.R. 4173, there is no requirement for a separate shareholder advisory vote on golden parachute payments in connection with a merger or acquisition**. Senate Bill § 951 (pp. 1073-1074); H.R. 4173 § 2002 (pp. 542-545).**

2. Compensation Committee Independence

The Senate Bill would amend the Exchange Act (15 U.S.C. § 78a et seq.) by inserting Section 10C governing standards relating to compensation committees. The section would require that the SEC, not later than 360 days after the date of enactment, direct the national securities exchanges and associations to prohibit the listing of any class of equity security of an issuer that is not in compliance with the rest of the section, but would give an issuer an opportunity to cure defects before the prohibition would go into effect. The SEC would have authority to exempt certain categories of issuers from the section's requirements. In particular, the legislation notes that the Commission may take into consideration the potential impact on smaller reporting issuers. **Senate Bill § 952 (pp. 1075-1076; 1081-1082).**

Section 952 of the Senate Bill provides that each member of a board's compensation committee must be independent under a definition of independence to be established by the exchanges. In adopting this definition, the exchanges must consider the sources of compensation paid to compensation committee members (including any consulting, advisory or other compensatory fees paid) and whether the members are affiliated with the issuer. **Senate Bill § 952 (pp. 1075-1076).**

This section also requires that any compensation consultants and other advisors retained by the compensation committee may only be selected after an issuer has taken into account independence factors to be established by the SEC. Section 952 directs those independence factors to include: (a) provision of other services by the person that employs the compensation consultant or advisor (the "Consulting Firm"), (b) the amount of fees received by the Consulting Firm as a percentage of its total revenue, (c) the Consulting Firm's policies designed to prevent conflicts of interest, (d) any business or personal relationship of the compensation consultant or advisor with a member of the compensation committee, and (e) any stock of the issuer owned by the compensation consultant or advisor. **Senate Bill § 952 (pp. 1076-1078).**

The compensation committee must be directly responsible for the appointment, compensation, and oversight of these consultants and advisors. However, the committee is not

be required to follow the recommendations of such consultants and advisors and shall continue to exercise its own judgment in fulfilling its duties. In each annual proxy statement filed by the issuer on or after one year following enactment of the Senate Bill, the issuer must disclose whether a compensation consultant is used, whether there are any conflicts of interest and how any such conflicts are being addressed. **Senate Bill § 952 (pp. 1078-1079)**

Similarly, the compensation committee shall have the authority to retain and obtain the advice of independent counsel and other advisors meeting the same standards for independence as the compensation consultants and advisors. Again, the committee will be directly responsible for the appointment, compensation and oversight of such independent counsel and other advisors, but shall not be required to follow the recommendation of such counsel or advisors. **Senate Bill § 952 (pp. 1079-1080)**

Each issuer will be required to provide for appropriate funding for independent compensation consultants, counsel and other advisors. **Senate Bill § 952 (pp. 1080-1081); H.R. 4173 contains provisions similar to all of those above at § 2003 (pp. 545-551).**

3. Executive Compensation Disclosures

Section 953 of the Senate Bill would amend Section 14 of the Exchange Act (15 U.S.C. § 78n) by adding a new subsection that would direct the SEC to adopt rules requiring an issuer to disclose in its annual proxy statement a clear description of any compensation required to be disclosed by the issuer under Item 402 of Regulation S-K (§ 229.402 of Title 17, Code of Federal Regulations), including the relationship between executive compensation actually paid and the issuer's financial performance, taking into account changes in the value of the shares of stock and dividends of the issuer and any distributions. The disclosure may, but is not required to, include a graphic representation of this required information. **Senate Bill § 953(a) (p. 1082).**

Additionally, this new subsection would direct the SEC to amend Item 402 of Regulation S-K (§ 229.402 of Title 17, Code of Federal Regulations) to require each issuer to disclose in its annual proxy statement (i) the median of annual total compensation of all employee, other than the chief executive officer (or any equivalent position), (ii) the annual total compensation of the chief executive officer (or any equivalent position) and (iii) the ratio of those two amounts. "Annual total compensation" is determined in accordance with Item 402(c) of Regulation S-K (§ 229.402(c) of Title 17, Code of Federal Regulations). **Senate Bill § 953(b) (p. 1083).**

4. Recovery of Erroneously Awarded Compensation (Clawback)

Section 954 of the Senate Bill would amend the Exchange Act (15 U.S.C. § 78a et seq.) by adding a new Section 10D providing for the adoption of mandatory "clawback" policies. The section would require that the SEC direct the national securities exchanges and associations to prohibit the listing of any class of equity security of an issuer that is not in compliance with the rest of the section. Note that there is no time period in which the SEC is required to direct the listing exchanges.

Issuers will be required to adopt clawback policies to recoup unearned payments awarded to executive officers, current or former, as incentive compensation during a three year look back period if the issuer is required to prepare an accounting restatement based on erroneous data due

to material noncompliance with any financial reporting requirement under the securities laws. Section 954 also includes a requirement regarding disclosure of the issuer's policy on incentive based compensation that is based on reported financial information. **Senate Bill § 954 (pp. 1084-1085).**

5. Disclosures Regarding Employee and Director Hedging

Section 955 of the Senate Bill would amend Section 14 of the Exchange Act (15 U.S.C. § 78n) by adding a new subsection that would direct the SEC to adopt rules requiring an issuer to disclose in its annual proxy statement whether its employees or directors may purchase financial instruments that are designed to hedge or offset decreases in the value of securities granted to employees or directors as a part of employee compensation or other securities held by the employees or directors. **Senate Bill § 955 (pp. 1085-1086).**

6. Excessive Compensation by Holding Companies of Depository Institutions

Section 956 of the Senate Bill would amend BHC Act § 5 (12 U.S.C. § 1844) to provide that no later than 180 days after the transfer date established by Section 311 of the Senate Bill, the Fed will establish standards prohibiting as an unsafe and unsound practice any compensation plan of a bank holding company that provides excessive compensation, fees or benefits to any employee, officer, director or principal shareholder or that could lead to material financial loss of the bank holding company. When establishing these standards, the Fed would be directed to take into consideration the standards described in section 39(c) of the FDIA (12 U.S. C. 1831p-1(c)), including the following: (i) the combined value of all cash and noncash benefits provided to the individual, (ii) the compensation history of the individual, (iii) the financial condition of the institution, (iv) comparable compensation practices and comparable institutions, (v) postemployment benefits and (vi) any other factors deemed appropriate or relevant. **Senate Bill § 956 (pp. 1086-1087); H.R. 4173 § 2004 (pp. 551-57).**

7. Voting by Brokers

Section 957 of the Senate Bill would amend Section 6(b) of the Exchange Act (15 U.S.C. § 78f(b)) by adding a new subsection that would prohibit a broker that is not the beneficial owner of an issuer's shares from granting a proxy to vote the shares in connection with a shareholder vote on director elections, executive compensation or other significant matters (as determined by the SEC by rule) unless the beneficial owner has provided the broker with voting instructions. **Senate Bill § 957 (pp. 1087-1088).**

E. Strengthening Corporate Governance

Subtitle G of Title IX contains corporate governance reforms aimed at all public companies, and amends certain provisions of the Exchange Act (15 USC § 78a et seq.) intended to strengthen corporate governance practices.

1. Majority Voting for Directors

Section 971 of the Senate Bill would amend the Exchange Act (15 U.S.C. § 78a et seq.) by inserting Section 14B governing standards relating to election of directors. The section would require that the SEC, not later than one year after the date of enactment, direct the national securities exchanges and associations to prohibit the listing of any class of equity security of an issuer that is not in compliance with the rest of the section, but would give an issuer an opportunity to cure defects before the prohibition would go into effect. The SEC would have authority to exempt certain categories of issuers from the section's requirements based on the size of the issuer, its market capitalization and number of shareholders of record, or other criteria.

Under Section 971, directors of an issuer would be required to receive a majority of votes cast by shareholders in uncontested elections, and a plurality in contested elections, in order to be elected to the board of directors. A director who did not receive a majority vote in an uncontested election would be required to tender his or her resignation. However, Section 971 gives issuers discretion to reject a resignation from a director who does not receive a majority vote in an uncontested election if the board unanimously rejects the resignation. If the board exercises this discretion, the board must within 30 days disclose the specific reasons it chose not to accept the resignation, including a discussion of the analysis used in reaching that conclusion, and that the decision was in the best interests of the issuer and the shareholders. **Senate Bill § 971 (pp. 1103-1106).**

2. Proxy Access

Section 972 of the Senate Bill would amend Section 14(a) of the Exchange Act (15 U.S.C. § 78n) by inserting a new subsection (2) that permits, but does not require, the SEC to adopt rules and regulations relating to the ability of shareholders to nominate directors in an issuer's proxy statement. Section 972 does not outline specifics of any such proxy access rules and regulations. **Senate Bill § 972 (pp. 1106-1107); H.R. 4173 § 7222 (pp. 1153 – 1154).**

3. Separation of Chairman and CEO

Section 973 of the Senate Bill would amend Section 14B of the Exchange Act (15 U.S.C. § 78n) by adding a new subsection that would direct the SEC to adopt rules, not later than 180 days of enactment, requiring an issuer to disclose in its annual proxy statement the reasons why they have chosen the same person, or different people, to serve as chairman of the board of directors and chief executive officer (or in equivalent positions of the issuer).[16] **Senate Bill § 973 (p. 1107).**

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[16] The SEC recently adopted amendments to its proxy rules to require issuers to provide disclosure about their board's leadership structure, including whether the positions of chairman and chief executive officer are combined or separate, and why the structure is appropriate for the issuer.

TITLE X — BUREAU OF CONSUMER FINANCIAL PROTECTION

Title X of the Senate Bill, the "Consumer Financial Protection Act of 2010," would create a new independent watchdog with the authority to regulate the offering and provision of consumer financial products or services. *In contrast to the House Bill, the Senate Bill creates a Bureau that will be housed inside the Federal Reserve rather than a new freestanding agency. Supporters of the structure proposed by the Senate Bill note that housing the Bureau of Consumer Financial Protection within the Federal Reserve would alleviate concerns that an independent agency would not pay enough attention to safety and soundness considerations or the overall health of the financial system. While supporters believe that the Federal Reserve has useful expertise and experience to support the Bureau, critics point to the Federal Reserve's prior lack of effectiveness in this arena and the conflict of interest inherent in a dual mission of protecting consumers while fulfilling its mission of safeguarding the rest of the financial system.*

Under the Senate Bill, consumer protection responsibilities currently handled by the Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation, Federal Reserve, National Credit Union Administration, and Federal Trade Commission will be transferred to and consolidated in the Bureau of Consumer Financial Protection (hereinafter the "Bureau"). The Bureau would be required to implement and enforce Federal consumer financial protection law for the purpose of ensuring that markets for consumer financial products and services are fair, transparent, and competitive. The Bureau would be charged with the mission and authority to ensure that consumers are provided with timely and comprehensible information about financial transactions and protected from unfair or deceptive acts and practices. The Bureau's primary functions would be conducting financial education programs; collecting, investigating, and responding to consumer complaints; collecting and publishing information about the market for consumer financial products and identifying consumer risks; supervising persons that offer consumer financial products and services; undertaking enforcement actions to address violations of Federal consumer financial law; and issuing rules, orders, and guidance to implement Federal consumer financial law.

A. Establishment and Administration of the Bureau

Title X provides a mandate to the Bureau to enforce federal consumer financial laws establishes the Bureau's functions with regard to regulation, supervision and enforcement. **Senate Bill § 1021 (p. 1249).**

The Bureau would be required to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that markets for consumer financial products and services are fair, transparent, and competitive. **Senate Bill § 1021(a) (p. 1249).**

1. Structure of the Bureau of Consumer Financial Protection

The Bureau would be housed within the Federal Reserve. **Senate Bill § 1011 (p. 1222).** The Director of the Bureau will be appointed by the President and confirmed by the Senate for a five-year term. **Senate Bill § 1011.**

In this regard, the Bureau of Consumer Financial Protection differs from the Consumer Financial Protection Agency proposed by the House Bill. The House Bill would create a freestanding agency, whereas the Senate Bill would create a bureau within the Federal Reserve. **H.R. 4173 § 4101.** However, the Senate Bill includes provisions to ensure the "autonomy" of the new consumer protection bureau (see below).

2. Autonomy of the Bureau

The Fed could delegate to the Bureau the authorities to examine persons subject to Fed jurisdiction for compliance with Federal consumer financial laws. The Fed could not however intervene in any matters or proceedings before the Bureau, such as examinations or enforcement actions, unless specifically provided by law. The Fed is also prohibited from appointing, directing, removing any of the Bureau's officers or employees, or consolidating any of the Bureau's functions with any of the Fed's divisions or offices. Furthermore, no rule or order of the Bureau would be subject to approval or review by the Fed. **Senate Bill § 1012(c) (pp. 1255-57).**

3. Consumer Advisory Board

Under the Senate Bill, the Director would be required to establish a Consumer Advisory Board. Six of the Board's members would be appointed by the Federal Reserve Bank Presidents. **Senate Bill § 1014 (p. 1237)**.

In contrast, the House Bill establishes a Consumer Financial Protection Oversight Board composed of the Chairman of the Board of Governors of the Federal Reserve, head of the agency responsible for chartering and regulating national banks, Chairperson of the FDIC, Chairman of the NCUA, Chairman of the FTC, Secretary of HUD, Chairman of the liaison committee of representatives of state agencies to the Financial Institutions Examination Council, and 5 additional experts appointed by the President. **H.R. 4173 § 4104(c),(d) (pp. 832-833).**

4. Special Functional Units

Under the Senate Bill, the Director would establish functional units to research, analyze, and report on:

- Market developments for consumer financial products or services, including market areas of alternative consumer financial products or services with high growth rates and areas of risk to consumers;
- Access to fair and affordable credit for traditionally underserved communities;
- Consumer awareness, understanding, and use of disclosures and communications regarding consumer financial products or services;
- Consumer awareness and understanding of costs, risks, and benefits of consumer financial products or services;
- Consumer behavior with respect to consumer financial products or services;

- Consumer affairs unit to offer information, guidance, and technical assistance to traditionally underserved consumers and communities;

- Unit with a toll-free telephone number, website, and database to collect and track complaints;

- Office of Fair Lending and Equal Opportunity; and

- Office of Financial Literacy.

Senate Bill §§ 1013(b), 1013(c), and 1013(d) (pp. 1228-35).

5. Functions of the Bureau

The Bureau would be authorized to exercise its authorities under Federal consumer financial law for the purposes of ensuring that, with respect to consumer financial products and services, (1) consumers are provided with timely and understandable information to make responsible decisions about financial transactions; (2) consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination; (3) outdated, unnecessary, or unduly burdensome regulations are regularly identified and addressed in order to reduce unwarranted regulatory burdens; (4) Federal consumer financial law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition; and (5) markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation. **Senate Bill § 1021(b) (pp. 1249-50).**

The primary functions of the Bureau would be (1) conducting financial education programs; (2) collecting, investigating, and responding to consumer complaints; (3) collecting, researching, monitoring, and publishing information relevant to the functioning of markets for consumer financial products and services to identify risks to consumers, and the proper functioning of such markets; (4) supervising covered persons for compliance with federal consumer financial law, and taking appropriate enforcement action to address violations; (5) issuing rules, orders, and guidance implementing federal consumer financial law; and (6) performing such support activities as may be necessary or useful to facilitate the other functions of the Bureau. **Senate Bill § 1021(c) (pp. 1250-51).**

6. Coordination

The Bureau would coordinate with the SEC and CFTC and Federal agencies and State regulators to promote consistent regulatory treatment of consumer financial and investment products and services. **Senate Bill § 1015 (p. 1238).**

7. Reports to Congress

The Director would be required to present an annual report to Congress not later than March 31 of each year on the complaints received by the Bureau in the prior year regarding consumer financial products and services. Such report shall include information and analysis about complaint numbers, types, and, where applicable, information about resolution of complaints. **Senate Bill § 1013(b)(3)(C) (p. 1230).**

The Director of the Bureau would appear before the Senate Banking Committee and the House Financial Services Committee at semi-annual hearings. **Senate Bill § 1016(a) (p. 1238).**

The Bureau would be required to prepare and submit a report to the President and to the Senate Banking Committee and the House Financial Services Committee. **Senate Bill § 1016(b) (p. 1039).** Such report would include (1) a discussion of the significant problems faced by consumers in shopping for or obtaining consumer financial products or services; (2) a justification of the budget request of the previous year; (3) a list of the significant rules, orders, and initiatives adopted by the Bureau; (4) an analysis of complaints about consumer financial products or services that the Bureau has received and collected in its central database; (5) a list of the public supervisory and enforcement actions to which the Bureau was a party; (6) the actions taken regarding rules, orders, and supervisory actions with respect to covered persons which are not credit unions or depository institutions; (7) an assessment of significant actions by state attorneys general or state regulators relating to federal consumer financial law; and (8) an analysis of the efforts of the Bureau to fulfill the fair lending mission of the Bureau. **Senate Bill § 1016(c) (pp. 1039-40).**

Under the House Bill, the Agency would be required to conduct an assessment addressing the effectiveness of each significant regulation prescribed or order issued by the Director. These findings must be reported to Congress within 3 years of the title's effective date. The report is subject to public notice and comment before it is published. **H.R. 4173 § 4207(b)(3) (pp. 938-939)**.

8. Audits of the Bureau

The Comptroller General would be required to annually audit the financial transactions of the Bureau in accordance with the United States generally accepted government auditing standards. **Senate Bill § 1017(a)(5)(A).**

Under the House Bill, the Comptroller General of the GAO would be required to study the effects of the Agency's regulations on small businesses and submit a report to Congress with its findings every three years. **H.R. 4173 § 4110 (p. 861)**.

9. Funding of the Bureau

The Fed would need to transfer to the Bureau the funds reasonably necessary to carry out its authorities. The Fed could transfer up to 10% of its combined expenditures in 2011, 11% in 2012, and 12% in 2013 and every year thereafter. **Senate Bill § 1017 (pp. 1040-41).**

Unlike the House Bill, the Senate Bill does not provide for assessments on covered persons to fund the Bureau. Rather, it appears that the Bureau would be funded only through a transfer of funds from the Fed and penalties collected through enforcement actions. In contrast, under the House Bill, the Director may assess fees on covered persons to meet the Agency's expenses. The assessments will be defined by regulation and based on the size and complexity of the risk posed by the covered person, its record of compliance with consumer laws, and such other factors as the Director deems appropriate. In determining fees and assessments, the regulations may take into account the outstanding number of consumer credit accounts, off-balance sheet receivables attributable to the covered person, total consolidated assets, total asset

under management, volume of consumer financial transactions, and use of service providers by the covered person. **H.R. 4173 § 4111(b) (pp. 862-863).**

B. Scope of the Bureau's Powers and Duties

1. Covered Persons, Service Providers, Consumers, and Activities

Title X covers any person that engages in offering or providing a consumer financial product or service. **Senate Bill § 1002(6) (p. 1204).** A consumer financial product or service is a financial product or service offered or provided for use by consumers primarily for personal, family, or household purposes, or delivered, offered or provided in connection with such a consumer financial product or service. **Senate Bill § 1002(5) (p. 1203-04).**

Financial products and services include extensions of credit and service of loans; real estate settlement services and property appraisals; taking deposits, transmitting or exchanging funds, or acting as a custodian of funds or any financial instrument for use by or on behalf of a consumer; sale, provision or issuance of a payment instrument or a stored value instrument over which the seller exercises substantial control; check cashing, collection, or guaranty services; financial data processing products or services; financial advisory services; and collection and provision of consumer report and credit history information. **Senate Bill § 1002(13) (pp. 1207-14).**

2. Persons and Activities Not Under the Authority of the Bureau

The Bureau does not have authority with respect to credit extended directly by merchants, retailers, or sellers of nonfinancial services exclusively to enable a consumer to purchase a nonfinancial good or service. Thus, the Bureau does not have authority over real estate brokerage activities, retailers of manufactured or modular homes, accountants or tax preparers, attorneys, employee benefit and compensation plans, or persons regulated by a state securities commission. **Senate Bill § 1027(a) (pp. 1287-92).**

Under the Senate Bill, the Bureau does not have authority over compensation plans; however, under the House Bill, the Director may prescribe regulations establishing duties regarding compensation practices of covered persons who deal or communicate directly with consumers in the provision of a consumer financial product or service. Howeve, the Director may not institute compensation caps. **H.R. 4173 § 4306(a)(3) (pp. 953-954)**

Unlike the House Bill, the Senate Bill explicitly excludes activities related to the writing of insurance or the reinsurance of risks from the purview of the Bureau. **Senate Bill § 1002(3) (p. 1203).** Under an amendment sponsored by Senator Snowe, certain small businesses are also carved out from the authority of the Bureau. **S.A. 3918.** However, the House Bill explicitly prevents the Agency from overseeing auto dealers, whereas the Senate Bill does not contain a similar provision. **H.R. 4173 § 4205 (pp. 920-929).**

Under the House Bill, the Agency has no authority over persons regulated by the Federal Housing Finance Agency, meaning federal home loan banks or their joint offices. **H.R. 4173 § 4205(f) (pp. 919-920).** Under Senator Dodd's amendment S.A. 3938 to the Senate Bill, the

Secretary of the Treasury is required to conduct a study on ending the conservatorship of Fannie Mae and Freddie Mac, and reforming the housing finance system. **S.A. 3938.**

Title X is not intended to modify the authority of the SEC or CFTC to adopt rules, initiate enforcement proceedings, or take other action with respect to persons or institutions regulated by those agencies. However, the SEC and CFTC would be required to consult and coordinate with the Bureau regarding rulemaking over any product or service subject to the Bureau's jurisdiction. **Senate Bill § 1015 (p. 1238).**

C. Information Collection and Monitoring

The Bureau would monitor for risks to consumers in the offering or provision of consumer financial products or services, including developments in markets for such products or services. **Senate Bill § 1022(c)(1) (p. 1254).** In allocating its resources to perform the monitoring the Bureau could consider (a) likely risks and costs to consumers associated with buying or using a type of consumer financial product or service; (b) understanding by consumers of the risks of a type of consumer financial product or service; (c) the legal protections applicable to the offering or provision of a consumer financial product or service, including the extent to which the law is likely to adequately protect consumers; (d) rates of growth in the offering or provision of a consumer financial product or service; (e) the extent, if any, to which the risks of a consumer financial product or service may disproportionately affect traditionally underserved consumers; or (f) other pertinent characteristics of covered persons that offer or provide the consumer financial product or service. **Senate Bill § 1022(c)(1) (p. 1254).**

The Bureau would be required to publish at least one report annually of significant findings of its monitoring. **Senate Bill § 1022(d) (p. 1259-60).** In conducting research on the offering and provision of consumer financial products or services, the Bureau would have the authority to gather information from time to time regarding the organization, business conduct, markets, and activities of persons operating in consumer financial services markets. In order to gather such information, the Bureau could gather and compile information from examination reports concerning covered persons or service providers, assessment of consumer complaints, surveys and interviews of covered persons and consumers, and review of available databases. The Bureau could also require persons to file with the Bureau, under oath or otherwise, in such form and within such reasonable period of time as the Bureau may prescribe, by rule or order reports, or answers in writing to specific questions. The Bureau could make public such information but shall prescribe rules regarding confidentiality. **Senate Bill § 1022(c)(4) (pp. 1255-56).**

D. Rulemaking Authority

The Director would have authority to prescribe rules and issue orders and guidance to enable the Bureau to administer Federal consumer financial laws. **Senate Bill § 1022 (p. 1251).** To the extent that a provision of federal consumer financial law authorizes the Bureau and another federal agency to issue regulations under that provision of law for purposes of assuring compliance with federal consumer financial law and any regula1tions thereunder, the Bureau shall have the exclusive authority to prescribe rules subject to those provisions of law. **Senate Bill § 1021(b)(4) (p. 1250).**

1. Standards for Rulemaking

In prescribing rules, the Bureau would be required consider the potential costs and benefits to consumers and covered persons, including any potential reduction of consumer access to financial products or services. The Bureau would need to consult with the prudential regulators and other appropriate Federal agencies before proposing a rule and during the comment process. If a prudential regulator provides a written exception to the proposed rule, the Bureau must include the objection in its adopting release. **Senate Bill § 1022(b)(2) (p. 1252).**

2. Prohibiting Unfair, Deceptive, or Abusive Acts or Practices

The Bureau could take action to prevent a person from committing an unfair, deceptive, or abusive act under Federal law in connection with any consumer financial product or service transaction or offering. **Senate Bill § 1021(b)(2) (p. 1250).**

3. Regulations Regarding Arbitration Agreements

By regulation, the Director could prohibit or impose conditions or limitations on the use of mandatory predispute arbitration agreements between a covered person and a consumer for a consumer financial product if such action is in the public interest and for the protection of consumers. However, the Bureau must first conduct a study of mandatory predispute arbitration provisions, and any limits imposed on arbitration agreements must be consistent with the findings of the study. **Senate Bill § 1028 (p. 1308).**

4. Regulations Governing Disclosures

The Bureau could prescribe regulations to ensure timely, appropriate and effective disclosures of costs, benefits, and risks associated with any consumer financial product or service. The Bureau could also issue model disclosures, which are per se compliant. The Bureau may permit a covered person to conduct a trial program to provide trail disclosures to consumers. **Senate Bill § 1032 (p. 1312).**

5. Review of Bureau Rules and Regulations

The Bureau would be required to conduct an assessment of each significant rule or order it adopts and publish a report within five years. In addition, on the petition of any of its member agencies, the Council could set aside any of the Bureau's regulations if it decides by 2/3 vote that regulation would put the safety and soundness of the banking system or the stability of the financial sector at risk. The agency would be required to first attempt to work with the Bureau in good faith to resolve any concerns. If this is unsuccessful, the agency would file its petition within 10 days after the publication of the regulation. **Senate Bill § 1023 (pp. 1260-62).**

The House Bill does not include any comparable mechanism by which other agencies can challenge final rules issued by the Consumer Financial Protection Agency and have them set aside. The Senate Bill reflects a more moderated balancing between consumer protection and safety and soundness considerations.

6. Exceptions

The Bureau could issue rules to exempt any covered person from any provision of Title X or regulations under Title X as the Director deems necessary or appropriate. In issuing such exemption, the Director must take into account the total assets of the covered person, its volume of transactions involving consumer financial products or services, and the extent to which existing laws or regulations adequately protect consumers. **Senate Bill § 1022(b)(3)(A) (p. 1253).**

7. Regulations Governing Interchange Fees

Under an amendment sponsored by Senator Durbin, the Federal Reserve would have authority to establish rules regarding interchange transaction fees that an issuer or payment card network may charge with respect to an electronic debit transaction. The rules will require that fees be reasonable and proportional to the actual cost incurred by the issuer or payment card network with respect to the transaction. However, such rules would not apply to issuers with assets of less than $10B. **Senate Bill § 1077 (p. 1464); as amended by S.A. 3989.** The House Bill does not contain a similar provision.

E. Supervisory and Examination Authority

1. Reporting Requirements

A non-depository covered person who offers mortgage origination, brokerage, or servicing for use by consumers or is a large participant in the market for consumer financial products and services ("large participant" to be defined by rulemaking) would be subject to periodic reports and examinations by the Bureau under a risk-based supervision program. The risk-based supervision program is based on the asset size of the covered person, its volume of transactions, and the risks to consumers created by its financial products. The Bureau would also have primary enforcement authority and exclusive rulemaking authority. **Senate Bill § 1024(a)(1) (p. 1265).**

Banks with over $10 billion in assets would be subject to periodic reports and examinations by the Bureau. The Bureau would also have primary enforcement authority over banks with over $10 billion in assets. **Senate Bill § 1025 (p. 1274).** For banks with less than $10B in assets, the prudential regulator would have exclusive enforcement authority. **Senate Bill § 1026 (p. 1284).**

Under the House Bill, in contrast, the existing regulators would continue to be responsible for consumer protection examinations of banks with less than $10 billion in assets, but the Agency would retain backup authority. **H.R. 4173 § 4203 (p. 898-906).**

2. Examinations

The Bureau would be required to periodically require reports and conduct examinations to assess compliance with Federal consumer financial law, obtain information about an institution's activities and compliance procedures, and detect risks to consumers. The Bureau also would have the authority to collect information regarding the organization, business

conduct, and practices of covered persons in order to conduct research on the provision of consumer financial products or services. The supervisory program would be risk-based and take into consideration the asset size of the covered person, the volume of its transactions involving consumer financial products or services, the risks to consumers created by such financial products or services, and the extent to which such entities are subject to oversight by state authorities. **Senate Bill § 1024(b)(1) (p. 1284).**

3. Conflicting Supervisory Determinations

To minimize regulatory burden, the Bureau would be required to coordinate its supervisory activities with the activities of prudential regulators and state bank regulatory authorities and use existing reports to the fullest extent possible. If the proposed supervisory determinations of the Bureau and the prudential regulator conflict, the covered person could request a joint statement. If the conflict is not resolved, the covered person could appeal to a governing panel consisting of a representative from the Bureau, a representative of the prudential regulator, and a representative from the Fed, the FDIC, the NCUA, or the OCC. **Senate Bill § 1024(b)(3) (p. 1285).**

Under the House Bill, the governing panel would be composed of three individuals—a representative from the Agency, a representative of the federal banking agency to which the appeal relates, and a representative from the federal banking agency that heads the Financial Institution Examination Council. **H.R. 4173 § 4204(e) (pp. 909-910).**

4. Illegal Acts

Under the Senate Bill, it would be unlawful for any person to:

- advertise, market, offer, or sell a consumer financial product or service not in conformity with this Title or applicable rules or orders issued by the Bureau;
- enforce, or attempt to enforce, any agreement with a consumer, or impose any fee or charge in connection with a consumer financial product or service that is not in conformity with this Title or applicable rules or orders;
- engage in any unfair, deceptive, or abusive act or practice;
- advertise, market, offer, sell, enforce, or attempt to enforce, any term, agreement, change in terms, fee or charge in connection with a consumer financial product or service that is not in conformity with this Title or applicable rules or orders;
- engage in any unfair, deceptive, or abusive act or practice; or
- fail or refuse to permit access to or copying of records. **Senate Bill § 1034 (pp. 1317-18).**

F. Enforcement Authority

1. General Enforcement Authority

Under the Senate Bill, to the extent that Federal law authorizes both the Bureau and another Federal agency to enforce Federal consumer financial law with regard to a non-depository person, the Bureau will have exclusive authority. To the extent that Federal law authorizes both the Bureau and another Federal agency to enforce Federal consumer financial law with regard to an insured depository institution with over $10 billion in assets, the Bureau will have primary enforcement authority. **Senate Bill § 1025(c) (pp. 1276-77).**

In contrast, the House Bill does not distinguish between non-depository and depository persons in this context: the Agency would have primary enforcement authority, with respect to cases where a federal law authorizes both the Agency and another federal agency to establish rules, conduct examinations, and enforce a given law, respectively. **H.R. 4173 § 4202(d),(e) (pp. 892-893).**

Any Federal agency could recommend to the Bureau, in writing, that the Bureau initiate a enforcement proceeding. If the Bureau fails to do so within 120 days, the other agency would be authorized to initiate a proceeding to the extent permitted by law. **Senate Bill § 1051(c)(3) (p. 1277).**

Under the Rockefeller/Hutchison amendment, the enforcement and regulatory authority under the FTC Act will be preserved following creation of the Bureau. The amendment directs the FTC and the Bureau to enter into a memorandum of understanding and coordinate their regulatory efforts to ensure that businesses are not subject to overlapping/dual regulations. **A.S. 3758**.

The House Bill requires that the FTC serve written notice to the Director of the Agency at least 30 days prior to initiating an enforcement action. If exigent circumstances are present, the FTC may provide notice immediately upon initiating the enforcement action. The Agency may intervene in the FTC enforcement action and, upon intervening, be heard on all matters arising in the enforcement action and file petitions for appeal as desired. **H.R. 4173 § 4202(e) (p. 893-895)**.

2. Enforcement Authority for Small Banks, Thrifts, and Credit Unions Under $10 billion

Under the Senate Bill, the prudential regulator would have exclusive authority to bring enforcement actions against institutions with less than $10 billion in assets. The Bureau could notify the prudential regulator of any violations, and the prudential regulator would be required to respond to the Bureau within sixty days. **Senate Bill § 1025(d) (p. 1286).**

Under the House Bill, the prudential regulator would retain primary enforcement authority over banks with less than $10 billion in assets. However, the Agency may recommend to the appropriate agency that it initiate an enforcement proceeding. If that agency fails to do so within 120 days of receiving the recommendation, the Agency may initiate such a proceeding. **H.R. 4173 § 4203(c) (pp. 899-901)** If the Agency becomes aware of potential noncompliance

with Title IV of H.R. 4173 or other enumerated consumer protection laws or regulations through the consumer complaint system (established by the Agency under section 4015(c)(3)), then the Director may directly investigate the institution and take any permitted action the Director deems appropriate. In cases where the Director determines that the appropriate agency has failed to adequately conduct consumer compliance examinations or bring appropriate enforcement actions against a small bank, thrift, or credit union, the Director may move for removal of that agency's enforcement power. The Director must provide notice to the given agency that it is considering removal and an Agency examiner must participate in the agency's examination process for at least one cycle prior to removal. The Director's removal order is automatically appealed to the Treasury Secretary. If the Secretary does not deny the order within 120 days, it will be deemed affirmed. Also, the Secretary will issue regulations that establish the standards the Director will apply in making removal determinations. Such standards must require the Director to consider examination reports, any enforcement actions, consumer complaints, and state attorneys general or private rights of action with regards to the institution. Upon removal, the Agency will have primary examination and enforcement power over the small bank, thrift, or credit union. **H.R. 4173 § 4205(e) (pp. 901-904)**

3. Joint Investigations and Civil Investigative Demands

The Bureau could engage in joint investigations and requests for information with the Secretary of Housing and Urban Development, the Attorney General, or both. Bureau investigators will have the authority to issue subpoenas requesting testimony or the production of materials, which are enforceable in Federal district court. If the Agency has reason to believe that a person has documentary material or any information relevant to a violation, the Agency could issue a civil investigative demand. If a person fails to comply with a civil investigative demand, the Bureau could file a petition for an order of enforcement in Federal district court. **Senate Bill § 1052 (p. 1344-47).**

4. Administrative Proceedings

The Bureau could conduct hearings and adjudication proceedings, including cease-and-desist proceedings, to enforce compliance with Title X and any issued regulations, or any other Federal law that the Bureau is authorized to enforce. **Senate Bill § 1053 (p. 1361).**

5. Civil Actions

The Bureau could also bring a civil action or seek civil penalties and equitable relief for violations of Title X, related regulations, or other consumer financial protection laws. When commencing a civil action, the Bureau must notify the Attorney General. **Senate Bill § 1054 (p. 1370).**

6. Relief Available

In an administrative proceeding or court action, the Bureau could seek specific forms of relief including the rescission or reformation of contracts, refund of money or return of real property, restitution, disgorgement for unjust enrichment, payment of damages, public notification of the violation and related costs, limits on the entity's activities or functions, or civil penalties. Exemplary or punitive damages are not permitted. The Bureau, state attorney general,

or state regulator could recover the costs it incurred in connection with the action if it is the prevailing party. **Senate Bill § 1055 (pp. 1372-73).**

First tier civil penalties would be limited to $5,000 for each day the violation continues. Second tier civil penalties, available for "recklessly" violations, would be limited to $25,000 for each day the violation continues. Third tier civil penalties, imposed for "knowing" violations, could not exceed $1,000,000 for each day the violation continues. The penalty would reflect the financial resources and good faith of the person charged, the gravity of the violation, the severity of risks or losses to the consumer, any history of previous violations, and "such other matters as justice may require." The Agency could also make referrals for criminal proceedings to the Attorney General whenever the Agency obtains evidence that a person has engaged in conduct that may constitute a violation of Federal criminal law. **Senate Bill § 1055(c) (pp. 1374-75).**

All civil penalties would be placed in the Victims Relief Fund. **Senate Bill § 1017(d)(1) (p. 1248).**

7. Whistleblower Protection

Title X provides whistleblower protection in so far as a covered person or service provider is prohibited from terminating or discriminating against a covered employee because that employee has provided information to the Agency or any other state, local, or Federal entity. Likewise, an employee could not be terminated or discriminated against because he or she objected to or refused to participate in any activity, policy, practice, or assigned task that the employee reasonably believed to be in violation of any law, or constitute an unfair, deceptive, or abusive practice. **Senate Bill § 1057 (pp. 1376-77).**

G. Transfer of Other Consumer Financial Protection Functions to the Agency

Consumer financial protection functions of the Federal Reserve, OCC, OTS, FDIC, NCUA, Department of Housing and Urban Development, and FTC would be transferred to the Bureau subject to backup enforcement authority. **Senate Bill § 1061(b) (pp. 1388-96).** Under the House Bill, the consumer financial protections of the FTC will also be transferred to the Agency with the exception of the FTC's enforcement power, which it will retain with regards to the Credit Repair Organization Act, Section 5 of the FTC Act, and the Telemarketing and Consumer Fraud and Abuse Prevention Act. **H.R. 4173 § 4601(a)(5)**.

H. Preemption Provisions

1. Current Law

From the inception of national banking, state laws regulating national banks have been preempted.[17] The National Bank Act, enacted following the Civil War, vested exclusive control over national banks in the federal government.[18] In short, the "history" of national banking "is one of interpreting grants of both enumerated and incidental 'powers' to national banks as grants of authority not ordinarily limited by, but rather ordinarily preempting, contrary state law."[19]

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[17] *E.g.*, *McCulloch v. Maryland*, 17 United States 316, 437 (1819) ("[T]his is a [state] tax on the operations of the bank, and is, consequently, a tax on the operation of an instrument employed by the government of the Union to carry its powers into execution. Such a tax must be unconstitutional."); *Osborn v. Bank of the United States*, 22 United States 738, 867 (1824) ("If the trade of the Bank be essential to its character, as a machine for the fiscal operations of the government, that trade must be as exempt from State control as the actual conveyance of the public money.").

[18] *Tiffany v. Nat'l Bank of Mo.*, 85 United States 409, 413 (1874) ("National banks have been National favorites. . . . It could not have been intended, therefore, to expose them to the hazard of unfriendly legislation by the States . . . ."); *Farmers' & Mechs.' Nat'l Bank v. Dearing*, 91 United States 29, 34 (1875) ("[T]he States can exercise no control over [national banks], nor in any wise affect their operation, except in so far as Congress may see proper to permit."); *Davis v. Elmira Sav. Bank*, 161 United States 275, 283 (1896) ("[A]n attempt by a state to define [national banks'] duties or control the conduct of their affairs is absolutely void, wherever such attempted exercise of authority expressly conflicts with the laws of the United States, and either frustrates the purpose of the national legislation or impairs the efficiency of these agencies of the federal government to discharge the duties for the performance of which they were created."); *Talbott v. Bd. of County Comm'rs*, 139 United States 438 (1891) (holding that territories possess the same power of taxing national banks enjoyed by states); *Easton v. Iowa*, 188 United States 220, 239 (1903) (holding that while a state "may declare, by special laws, certain acts to be criminal offenses when committed by officers or agents of its own banks and institutions, . . . it is without lawful power to make such special laws applicable to banks organized and operating under the laws of the United States.").

[19] *Barnett Bank v. Nelson*, 517 United States 25 (1996); *Franklin Nat'l Bank of Franklin Square v. New York*, 347 United States 373 (1954) (holding that a New York statute forbidding the use of the word 'savings' by any banks other than its own charter banks was preempted by conflicting provisions of the Federal Reserve Act and National Bank Act).

Under current law, preemption extends to banking activities conducted by an operating subsidiary of a national bank.[20] However, the federal banking laws have been held not to preempt state officials' enforcement of their own fair-lending laws.[21]

2. Relation to State Law

The Senate Bill states that, except as otherwise provided in this Title, federal law "shall not be construed as annulling, altering, or affecting" state law unless the state law "is inconsistent with the provisions of this Title and then only to the extent of the inconsistency." State law is not inconsistent if it affords consumers greater protection than federal law. Determination of inconsistency "may be made by the Bureau on its own motion or in response to a non-frivolous petition initiated by any interested person." **Senate Bill § 1041(a) (p. 1324).** However, the preemptive effect of "enumerated [federal] consumer laws" is preserved. **Senate Bill § 1041(b) (p. 1325).**

The Bureau will be required to issue a notice of proposed rulemaking when the majority of states enact a resolution supporting a consumer protection regulation. In prescribing a final regulation, the Bureau will consider whether the proposed regulation will afford greater consumer protection than existing regulations, whether the benefits outweigh increased costs and inconveniences to consumers, whether the regulation could lead to any unfair discrimination, and whether any federal banking Bureau has determined that the proposed regulation would present an unacceptable safety and soundness risk to insured depository institutions. If the Bureau enacts a regulation, it is required to publish a discussion of its considerations in the Federal Register notice of the final regulation. If the Bureau decides not to issue a regulation, it must publish an explanation of its determination in the Federal Register and provide copies to each state enacting a resolution in favor of the regulation, the House Financial Services Committee, and the Senate Banking Committee. **Senate Bill § 1041(c) (pp. 1325-26).**

Section 1041 would effectively supplant the existing regime of "complete" preemption, under which all state laws that "touch upon" the business of banking are preempted,[22] with a

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[20] *Watters v. Wachovia Bank*, 550 United States 1, 21 (2007) ("The NBA is thus properly read by OCC to protect from state hindrance a national bank's engagement in the 'business of banking' whether conducted by the bank itself or by an operating subsidiary, empowered to do only what the bank itself could do.").

[21] *Cuomo v. Clearing House Ass'n*, 129 S. Ct. 2710 (2009) (holding that an action by a state attorney general to enforce a state law against a national bank is not preempted because it is not an exercise of "visitorial powers").

[22] In *Barnett Bank v. Nelson*, the Supreme Court held that a federal statute permitting national banks in small towns to sell insurance preempted a state law prohibiting national banks from doing so. 517 United States 25 (1996). In *Watters v. Wachovia Bank*, the Supreme Court

[Footnote continued on next page]

milder form of "conflict" preemption, in which only conflicting state laws are preempted.[23] The Bill specifies that "more protective" state laws are not in conflict.[24] In the absence of a complete preemption doctrine, suits against national banks will no longer be removable to federal court (i.e., some other basis for removal would have to be found), with the result that more cases would proceed in state court. It should be noted that whether a state law provides "greater protection" than federal law (and therefore is not preempted) is a debatable issue that is likely to engender litigation as well as strategic legislation and rulemaking in the states. In general, many state laws that are preempted under current law could be enforced under this provision. **Senate Bill § 1041 (pp. 1324-27).**

3. Preservation of Enforcement Powers of States

The Bill permits state attorneys general to sue in federal or state court to enforce and secure remedies under provisions of this Title or regulations issued thereunder, or otherwise provided under other law. **Senate Bill § 1042(a) (pp. 1327-28).** State attorneys general must notify the Bureau of any action to enforce any provision of this Title or any regulation issued thereunder, and the Bureau may intervene in such an action. **Senate Bill § 1042(b) (pp. 1329-31).** The Director will issue regulations to implement this section and provide guidance for the coordination of action with state regulators. **Senate Bill § 1042(c) (p. 1331).**

Under the Carper amendment, state attorneys general may bring suit against a national bank or federal savings association only to enforce a regulation prescribed by the Bureau under a provision of Title X and to secure remedies under provided under title X or other law. **Senate Bill § 1042(a)(2)(B) (pp. 1328-29); S.A. 4071.** State attorneys general may not otherwise bring a civil action against a national bank or federal savings association with respect to an act or omission that would be a violation of a provision of Title X. **Senate Bill § 1042(a)(2)(A) (p. 1328).**

Section 1042 specifies that no provision of this section should be construed as limiting the authority of a state attorney general or state regulator to bring an action or other regulatory proceeding arising solely under the law of that state. Section 1042 expands upon *Cuomo v.*

[Footnote continued from previous page]

held that a national bank, which is subject to supervision by the Office of the Comptroller, was not subject to the visitorial powers of the states.

[23] *See*, *e.g.*, *Geier v. Am. Honda Motor Co.*, 529 United States 861 (2000) (holding that an action under D.C. tort law against an automobile manufacturer asserting negligence for failure to provide airbags was preempted because it actually conflicted with a Department of Transportation standard).

[24] This form of preemption follows *Fla. Lime & Avocado Growers v. Paul*, in which the mere existence of a less restrictive federal law in the same arena did not raise a preemptive conflict. Under the *Fla. Lime* standard, state law is not preempted unless it is "physically impossible" to comply with both state and federal law. 373 United States 132 (1963).

Clearing House by broadly authorizing state officials to enforce not only state law, but all the provisions of "this Title," including regulations issued under this Title. By giving the Bureau discretionary authority to intervene, this provision recognizes concurrent federal-state authority (rather than exclusive federal authority). **Senate Bill § 1042(d) (pp. 1331-32).**

Furthermore, the statute will not affect the authority of a state securities commission or state insurance commission to take any action under state law with respect to a regulated person. As a result, state securities and insurance laws may *never* be preempted by the federal banking laws, even if there is an actual conflict. **Senate Bill § 1042(d) (pp. 1331-32).**

4. Preservation of Existing Contracts

The statute and implementing regulations "shall not be construed to alter or affect the applicability of any OCC or OTS regulation regarding the applicability of state law under federal banking law to any contract entered into on or before the date of the enactment of this Title." **Senate Bill § 1043 (p. 1332).** Section 1043 preserves extant OCC and OTS regulations insofar as they apply to pre-enactment contracts; the negative implication is that these regulations will be abrogated (or at least cast into doubt) to the extent that contractual rights are not implicated.

5. State Law Preemption Standards for National Banks and Subsidiaries Clarified

State consumer financial law is preempted only if (1) its application would have a discriminatory effect on national banks as compared to state-chartered banks; (2) it is determined (by a court or the Comptroller) to run afoul of the *Barnett Bank* preemption standard; or (3) it is preempted by another federal law. **Senate Bill § 1044(b)(1) (pp. 1334-35).** Under its savings clause, the statute "does not preempt, annul, or affect the applicability of any State law to any subsidiary or affiliate of a national bank (other than a subsidiary or affiliate that is chartered as a national bank." **Section 1044(b)(2) (p. 1335).**

The Comptroller must make case-by-case preemption determinations in consultation with the Bureau; this duty is non-delegable. Preemption determinations must be made public, submitted to Congress, and periodically reviewed by the Comptroller. **Senate Bill § 1044(b)(3) (p. 1335).** Under the version of the bill reported out of the Senate Banking Committee, the Comptroller was required to make a written finding that federal law provides a substantive standard governing the particular conduct at issue. However, this requirement was removed by the Carper amendment. In his statement on the amendment, Carper indicated, "This is the cop on the beat that we need. Consumers benefit from a national banking system that has uniform standards. The Dodd legislation, unfortunately, would weaken that bureau and hand over its enforcement tools to the states. This would only create more confusion that would inadvertently hurt consumers. My amendment is a sound compromise that would establish clear lines of responsibility at the federal and state level."

In sum, Title X makes explicit that the Act does not occupy the field in any area of state law. Courts finding preemption must make a de novo finding that federal law provides a substantive standard governing the particular conduct at issue. Also, by requiring "case-by-case" preemption determinations, this provision would appear to invalidate (or at least call into

question) some of the OCC's existing regulations, which determine that certain categories of state law conflict with federal law. (However, note that Section 1043, discussed above, preserves extant OCC and OTS regulations insofar as they apply to pre-enactment contracts.) The statement that the Act does not "occupy the field" reiterates the directive that only "conflict"-type preemption is to apply.

6. Visitorial Standards

Visitorial powers[25] provisions of federal law do not limit the authority of a state attorney general to bring an action to enforce any applicable federal or state law, after consultation with the appropriate federal agency. State attorneys general may also seek "relief" authorized by federal or nonpreempted state law. The ability of federal officials to bring an enforcement action "shall not be construed as precluding private parties from enforcing rights granted under Federal or State law in the courts." **Senate Bill § 1047 (p. 1342).**

Section 1047 essentially codifies the *Cuomo* decision by stating that the "visitorial powers" under federal law do not preclude state enforcement actions (although state officials are now required to consult with the appropriate federal agency). The additional authorization for state officials to seek "relief" authorized by nonpreempted state law may indicate that damages or other monetary claims (including claims where the attorney general sues on behalf of individual citizens) could be permitted. The statement that private parties are not precluded from "enforcing rights granted" could lead to litigation over whether or not Congress intended to imply any private rights of action.

7. Clarification of Law Applicable to Non-Depository Institution Subsidiaries

"No provision of this Title shall be construed as preempting, annulling, or affecting the applicability of State law to any nondepository institution, subsidiary, other affiliate, or agent of a national bank." **Senate Bill § 1045 (p. 1340).** H.R. § 4406 would effectively overrule *Watters* by making state law applicable to non-depository subsidiaries even if that same law would be preempted if applied to a national bank parent.

8. Federally Chartered Savings Associations

Senate Bill § 1046 applies provisions parallel to H.R. § 4404-4406 to federally chartered savings associations. **Senate Bill § 1046 (p. 1341).**

9. Effective Date

This subtitle shall take effect on the designated transfer date, 180 days after enactment. **Senate Bill § 1048 (p. 1343).**

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[25] Under the National Bank Act, visitation refers to government supervisory powers over corporations. *Cuomo*, 129 S. Ct. at 2271.

TITLE XI — FEDERAL RESERVE SYSTEM PROVISIONS

A. Amendments to the Fed's Emergency Lending Authority

1. Emergency Lending by the Fed Under Section 13(3)

Section 13(3) of the Federal Reserve Act allows the Federal Reserve to lend "under unusual and exigent" circumstances to companies that are not depository institutions. Under this current law, in unusual and exigent circumstances, the Fed may authorize a Reserve Bank to provide emergency credit to individuals, partnerships, and corporations that are not depository institutions. Such lending may occur only when, in the judgment of the Reserve Bank, credit is not available from other sources and failure to provide credit would adversely affect the economy. Specific approval by the Fed is required.

The Federal Reserve used this authority in several programs and actions taken during the fall of 2008, including to provide financial assistance to American International Group and to establish the Term Asset Backed Securities Loan Facility (TALF), Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), and Commercial Paper Funding Facility (CPFF). The Federal Reserve declined to use its Section 13(3) authority to assist Lehman Brothers.

The Senate Bill would amend Section 13(3) of the Federal Reserve Act to provide that the Fed may authorize such emergency credit to a participant in any program or facility with broad-based eligibility. **Senate Bill § 1151.** Further, the Bill would require the Fed to establish, by regulation and in consultation with the Secretary of the Treasury, the polices and procedures governing emergency lending under Section 13(3). Such policies and procedures would be required to ensure that the purpose of the emergency lending program is providing liquidity to the financial system and not to aid a failing financial company and that the collateral for emergency loans is of sufficient quality to protect taxpayers from losses. The Fed would not be permitted to establish an emergency lending program without the prior approval of the Secretary of the Treasury. **Senate Bill § 1151.**

2. Reports by the Fed to Congress

The Fed would be required to provide a report to the Senate Banking Committee and the House Financial Services Committee containing:

- The justification for the exercise of the Fed's authority to provide emergency assistance;
- The identity of the recipients of such assistance;
- The date and amount of the assistance and the form in which it was provided; and
- The material terms of the assistance (such as duration, collateral pledged, interest and fees collected) and requirements imposed).

Once every thirty days, the Fed would be required to provide written updates with respect to outstanding loans or financial assistance, which detail the value of the collateral, the amount of interest and fees received, and the expected or final cost to taxpayers. **Senate Bill §1151.**

3. Disclosures

The Senate Bill would require the Fed to disclose, within one year of when the assistance is first provided, the identity of the participants in an emergency lending program under this Section and the amounts borrowed by each participants, as well as identifying details concerning the assets or collateral held in connection with the program. **Senate Bill §1151.**

The Fed would not be required to disclose the identify of the participants in the emergency lending program if it determines that such disclosure is likely to reduce the effectiveness of the program or would otherwise have a significant effect on the economic or financial market conditions. If it decided not to make such disclosures, the Fed would be required to provide the Senate Banking Committee and House Financial Services Committee with a written report explaining the reason for delaying such disclosure. **Senate Bill §1151.**

B. GAO Reviews of Special Federal Reserve Credit Facilities

Under the Senate Bill, the independent Government Accounting Office (GAO) would be authorized to conduct reviews, including onsite examinations of the Fed, a Federal Reserve Bank, or a credit facility if the GAO determined such a review was appropriate for assessing the operational integrity, effectiveness, and fairness of such a credit facility. A "credit facility" is defined as any utility, facility, or program authorized by the Fed under § 13(3) of the Federal Reserve Act, including the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Term Asset-Back Securities Loan Facility, the Primary Dealer Credit Facility, the Commercial Paper Funding Facility, and the Term Securities Lending Facility. **Senate Bill § 1152.**

1. Reporting Requirements

The GAO would be required to submit reports on such reviews to the Congress within 90 days of completing the review. The report would include a detailed description of the findings and conclusions of the GAO as well as recommendations for legislative or administrative action as appropriate. The GAO would not be permitted to disclose the names or identifying details of specific participants in any credit facility and the report would be redacted to ensure that names and details are not disclosed. However, if the Fed has publicly disclosed such details, then the GAO's non-disclosure obligation would expire. Additionally, the GAO would be required to release a non-redacted version of the report one year after the Fed has terminated the authorization for the credit facility. **Senate Bill § 1152.**

2. Public Access to Information

The Senate Bill would amend Section 2B of the Federal Reserve Act to require that the Fed such make information publicly available including the reports prepared by the GAO, the annual financial statements prepared by an independent auditor of the Fed, and the reports to

Congress provided regarding the emergency lending authority, as well as any other information the Fed believes is necessary or helpful to the public. **Senate Bill § 1153.**

C. GAO Audit of Fed

One amendment was adopted with respect to Title XI. Senator Bernie Sanders proposed amendment S.A. 3738, which was adopted unanimously with four senators not voting, that would require the GAO to conduct a single, limited, independent audit of the Fed. This one time audit contrasts with an alternative proposal that would have subjected the Fed to perpetual GAO audits.

D. FDIC Emergency Financial Stabilization Program

1. Liquidity Event Determination

The Senate Bill establishes parameters under which the FDIC would be allowed to create an emergency financial stabilization program. First, the FDIC and the Fed would be required to determine whether that a liquidity event exists, which requires a vote of at least 2/3 of members of each institution. The determination would include an evaluation of the evidence that a liquidity events exists, that a failure to take action would have serious adverse effects on financial stability or economic conditions in the United States, and that an emergency financial stabilization program is needed to avoid or mitigate potential adverse effects on the United States financial system. **Senate Bill § 1154(a-b).**

The Secretary of the Treasury would also be required to provide his/ her written consent, as well maintain the written documentation for each determination and provide this documentation to the GAO for its review. The GAO would be required to review and report to Congress on any liquidity event determination, including the basis for the determination and the likely effect of the actions taken. **Senate Bill § 1154(c); H.R. 4173 § 1109 (a-b).**

For the purposes of this section, a "liquidity event" is defined as either (1) a reduction in the usual ability of financial market participants to sell a type of financial assets without a significant reduction in price or to borrow using that asset as collateral without a significant increase in margin, or (2) a significant reduction in the usual ability of financial and nonfinancial market participants to obtain unsecured credit. **Senate Bill § 1155(g)(3).**

2. Creation of Emergency Financial Stabilization Program

Upon such a determination, the FDIC would be authorized to create a widely available program to guarantee obligations of solvent insured depository institutions or solvent depository institution holding companies if necessary to prevent systemic financial instability during times of severe economic distress. Such guarantees, however, may not include the provision of equity in any form. **Senate Bill § 1155(a).** As soon as practicable, after the Senate Bill is enacted into law, the FDIC would be required to establish by regulation, with the concurrence of the Secretary, policies and procedures governing the issuance of these guarantees. **Senate Bill § 1155(b); H.R. 4173 § 1109 (a-b).**

3. Maximum Debt Guaranteed

The Secretary of the Treasury, in consultation with the President, determines the maximum amount of debt outstanding that the FDIC would be allowed to guarantee under this program. The President would then transmit a plan with the maximum delineated guarantee amount to Congress, which would have 5 calendar days to issue a joint resolution disapproving the report. **Senate Bill § 1155(c)(1).** If the Secretary, in consultation with the President, determines that the maximum guarantee amount should be raised, and the Council concurs, then the President could transmit a written report to Congress about the plan to issue guarantees up to the increased maximum debt guarantee amount. Again, Congress would have 5 calendar days to issue a joint resolution disapproving such report. **Senate Bill § 1155(c)(2).** The procedures governing the joint resolution required by Congress are outlined in the Senate Bill. **Senate Bill § 1155(d); H.R. 417 § 1109(c).**

4. Funding

Funds would be appropriated to the FDIC as necessary for the cost of the guarantees authorized, to pay reasonable costs of administering the program, and the amount necessary for discharging obligations under any guarantee issued in the event that the loan recipient defaults. The FDIC would be required to charge fees and other assessments to all participants in the program in amounts necessary to offset projected losses and administrative expenses. If such fees are insufficient, the FDIC would be permitted to impose a special assessment on participants in the program. If there are excess funds at the conclusion of the program, the funds would be deposited in the General Fund of the Treasury. **Senate Bill § 1155(e).**

The FDIC would also be authorized to borrow funds from the Secretary of the Treasury and issue obligations of the FDIC to the Secretary for amounts borrowed in order to carry out a financial stabilization program. The obligations issued shall be repaid in full with interest through fees and charges paid by participants. The Secretary may purchase any obligations so issued. **Senate Bill § 1155(e); H.R. 4173 § 1109(d).**

E. Additional Related Amendments

1. Suspension of Parallel Federal Deposit Insurance Act Authority

Upon enactment, the FDIC would be prohibited from exercising its authority under section 13(c)(4)(G)(i) to establish any widely available debt guarantee program, such as that provided for under Section 1155 of the Senate Bill. **Senate Bill § 1156(a); H.R. 4173 §1110(a).**

2. Effect of Default on an FDIC Guarantee

If an insured depository institution or depository institution holding company participating in the emergency stabilization program defaults on any obligation guaranteed by the FDIC, the FDIC could appoint itself as receiver for the insured depository institution that defaults. With respect to a participating company that is not an insured depository institution and defaults, the FDIC could require consideration of whether a determination shall be made under Section 202 to resolve the company under Section 203 (the provisions concerning enhanced

dissolution authority). If FDIC is not appointed receiver pursuant to Title II within 30 days of default, the FDIC could require the company to file a petition for bankruptcy under section 301 of Title 11 United States Code, which is amended to allow for such an involuntary petition for bankruptcy. **Senate Bill § 1156(c); H.R. 4173 § 1110(b), (c).**

F. Federal Reserve Bank Governance and Supervision

The Senate Bill would amend the Federal Reserve Act to establish that after the enactment of this legislation, the president of the Federal Reserve Bank of New York would be appointed by the President, with the advise and consent of the Senate, for a term of five years. **Senate Bill § 1157.**

Notwithstanding any other provision of Section 1157, after the Bill's enactment, no company or subsidiary or affiliate of a company that is supervised by the Fed may vote for members of the board of directors of a Federal Reserve Board. No past or current officer, director, or employee of such company or subsidiary or affiliate may serve as a member of the board of directors of a Federal Reserve Bank. **Senate Bill § 1157.**

Further, the Senate Bill would establish the position of Vice Chairman for Supervision at the Fed. The Vice Chairman of Supervision would be responsible for developing policy recommendations for the Fed regarding supervision and regulation of depository institution holding companies and other financial firms supervised by the Fed, and would oversee the supervision and regulation of such firms. The Vice Chairman would be required to appear before the Senate Banking Committee and House Financial Services Committee at annual hearings. Additional amendments are made to the Federal Reserve Act stating that the Fed may not delegate its functions regarding the supervision and regulation of depository institution holding companies and other financial firms to a Federal reserve Bank. **Senate Bill § 1158(a).**

TITLE XII —

Not covered.

TITLE XIII —

The amendments create a new Title XIII for the Senate Bill – titled "Miscellaneous" – that contain two of the new amendments.

A. IMF Lending

S.A. 3986, proposed by Senator Cornyn, creates new Section 1301 of the Senate Bill. This provision amends the Bretton Woods Agreements Act to require the President of the United States to direct the Executive Director of the International Monetary Fund to evaluate any proposed loan to a country where the public debt of the country exceeds the GDP of the country to determine "whether or not the loan will be repaid". By this it appears to mean the Executive Directors is to determine the probability of the loan being repaid. Where it is determined that repayment is "unlikely", the the President is required to direct the Executive Director to use the "voice and vote" of the United States to oppose the proposed loan.

B. Congo Conflict Minerals

S.A. 3997, proposed by Brownback, would require the SEC to promulgate rules within 180 days of enactment requiring that companies disclose the measures taken, including whether an independent audit was conducted, to track the chain of custody and ensure that certain minerals did not finance armed groups in the Democratic Republic of Congo. The requirement would apply to any person using these minerals in the production of a product.

Appendix A – Amendments to the Senate Bill

Amendment	Sponsor	Description	Vote
3737	Boxer (D-CA)	Prohibit taxpayers from ever having to bail out the financial sector	96-1
3738	Sanders (I-VT)	GAO Independent audit of the Board of Governors	96-0
3749	Hutchison (R-TX)	Broadens the FDIC assessment base	98-0
3755	Snowe (R-ME)	Reduce burdensome reporting requirments by CFPB on community banks	voice vote
3757	Snowe (R-ME)	Preserves small business access to credit by allowing for consideration of seasonal income in mortgage lending	voice vote
3758	Rockefeller (D-WV)	Preservation of FTC authority	voice vote
3759	Hutchison (R-TX)	Fed to regulate state and small banks	90-9
3774	LeMieux (R-FL)	End rating agencies monopoly	61-38
3786	Cantwell (D-WA)	CFTC market manipulation authority and prohibitions	voice vote
3827	Shelby (R-AL)	Changes to Resolution authority	93-5
3840	Cardin (D-MD)	Extend whistleblower protection to NRSOs employees	voice vote
3879	Collins (R-ME)	Leverage and risk-based capital requirements	UC
3883	Snowe (R-ME)	Small business fairness and regulatory transparency	voice vote
3892	Bingaman (D-NM)	Regulation of energy swaps by FERC	voice vote
3918	Snowe (R-ME)	Modifies the CFPB with respect to small business exemptions	voice vote
3928	Bennet (D-CO)	Apply recaptured taxpayer investments toward reducing national debt.	voice vote
3938	Dodd (D-CT)	Study on Fannie and Freddie	63-36
3943	Reed (D-RI)	Military liaison office in CFPB	98-1
3956	Landrieu (D-LA)	Exempt qualified residential mortgages from credit risk retention requirements	UC
3962	Merkley (D-OR)	Mortgage underwriting standards	63-36
3986	Cornyn (R-TX)	IMF	94-0
3989	Durbin (D-IL)	Interchange fees	64-33
3991	Franken (D-MN)	Credit rating agencies	64-35

3992	**Crapo (R-ID)**	**Provide for credit risk retention requirements for commercial mortgages**	**UC**
3997	**Brownback (R-KS)**	**SEC reporting requirement for Congo conflict commodities**	**voice vote**
4003	**Vitter (R-LA)**	**Protect manufacturers and entrepeneurs from unintended regulation**	**UC**
4016	**Udall (D-CO)**	**Free accesss to FICO scores**	**voice vote**
4056	**Bond (R-MO)**	**Angel Investors**	**voice vote**
4071	**Carper (D-DE)**	**Preemption**	**80-18**
4072	**Grassley (R-IA)**	**Strengthen role of IGs**	**75-21**
4146	**Ensign (R-NV)**	**Casino exemption**	**UC**

Gibson Dunn has assembled a team of experts who are prepared to meet client needs as they arise in conjunction with the issues discussed above. Please contact Michael Bopp (202-955-8256, mbopp@gibsondunn.com) or C. F. Muckenfuss (202-955-8514, cmuckenfuss@gibsondunn.com) in the firm's Washington, D.C. office, Kimble Charles Cannon (310-229-7084, kcannon@gibsondunn.com) in the firm's Los Angeles office, or any of the following members of the firm's Financial Regulatory Reform Group:

Public Policy Expertise
Mel Levine - Century City (310-557-8098, mlevine@gibsondunn.com)
John F. Olson - Washington, D.C. (202-955-8522, jolson@gibsondunn.com)
Amy L. Goodman - Washington, D.C. (202-955-8653, agoodman@gibsondunn.com)
Alan Platt - Washington, D.C. (202-887-3660, aplatt@gibsondunn.com)
Michael Bopp - Washington, D.C. (202-955-8256, mbopp@gibsondunn.com)

Securities Law and Corporate Governance Expertise
Ronald O. Mueller - Washington, D.C. (202-955-8671, rmueller@gibsondunn.com)
K. Susan Grafton - Washington, D.C. (202-887-3554, sgrafton@gibsondunn.com)
Brian Lane - Washington, D.C. (202-887-3646, blane@gibsondunn.com)
Lewis Ferguson - Washington, D.C. (202-955-8249, lferguson@gibsondunn.com)
Barry Goldsmith - Washington, D.C. (202-955-8580, bgoldsmith@gibsondunn.com)
John H. Sturc - Washington, D.C. (202-955-8243, jsturc@gibsondunn.com)
Dorothee Fischer-Appelt - London (+44 20 7071 4224, dfischerappelt@gibsondunn.com)
Alan Bannister - New York (212-351-2310, abannister@gibsondunn.com)
Adam H. Offenhartz - New York (212-351-3808, aoffenhartz@gibsondunn.com)
Mark K. Schonfeld - New York (212-351-2433, mschonfeld@gibsondunn.com)
George B. Curtis - Denver (303-298-5743, gcurtis@gibsondunn.com)
Paul J. Collins - Palo Alto (650-849-5309, pcollins@gibsondunn.com)
Robert C. Blume - Denver (303-298-5758, rblume@gibsondunn.com)
David P. Burns - Washington, D.C. (202-887-3786, dburns@gibsondunn.com)
Charles R. Jaeger - San Francisco (415-393-8331, cjaeger@gibsondunn.com)

Financial Institutions Law Expertise
C.F Muckenfuss - Washington, D.C. (202-955-8514, cmuckenfuss@gibsondunn.com)
Christopher Bellini - Washington, D.C. (202-887-3693, cbellini@gibsondunn.com)
Amy Rudnick - Washington, D.C. (202-955-8210, arudnick@gibsondunn.com)
Dhiya El-Saden - Los Angeles (213-229-7196, delsaden@gibsondunn.com)
Kimble C. Cannon - Los Angeles (310-229-7084, kcannon@gibsondunn.com)
Rachel Couter - London (+44 20 7071 4217, rcouter@gibsondunn.com)

Corporate Expertise
Howard Adler - Washington, D.C. (202-955-8589, hadler@gibsondunn.com)
Richard Russo - Denver (303-298-5715, rrusso@gibsondunn.com)
Dennis Friedman - New York (212-351-3900, dfriedman@gibsondunn.com)

Robert Cunningham - New York (212-351-2308, rcunningham@gibsondunn.com)
Joerg Esdorn - New York (212-351-3851, jesdorn@gibsondunn.com)
Wayne P.J. McArdle - London (+44 20 7071 4237, wmcardle@gibsondunn.com)
Stewart McDowell - San Francisco (415-393-8322, smcdowell@gibsondunn.com)
C. William Thomas, Jr. - Washington, D.C. (202-887-3735, wthomas@gibsondunn.com)

Private Equity Expertise
E. Michael Greaney - New York (212-351-4065, mgreaney@gibsondunn.com)

Private Investment Funds Expertise
Edward Sopher - New York (212-351-3918, esopher@gibsondunn.com)
Jennifer Bellah Maguire - Los Angeles (213-229-7986, jbellah@gibsondunn.com)

Real Estate Expertise
Jesse Sharf - Century City (310-552-8512, jsharf@gibsondunn.com)
Alan Samson - London (+44 20 7071 4222, asamson@gibsondunn.com)
Fred Pillon - San Francisco (415-393-8241, fpillon@gibsondunn.com)
Dennis Arnold - Los Angeles (213-229-7864, darnold@gibsondunn.com)
Michael F. Sfregola - Los Angeles (213-229-7558, msfregola@gibsondunn.com)
Andrew Lance - New York (212-351-3871, alance@gibsondunn.com)
Eric M. Feuerstein - New York (212-351-2323, efeuerstein@gibsondunn.com)
David J. Furman - New York (212-351-3992, dfurman@gibsondunn.com)
L. Mark Osher - Los Angeles (213-229-7694, mosher@gibsondunn.com)
Drew C. Flowers - Los Angeles (213-229-7885, dflowers@gibsondunn.com)
Teresa J. Farrell - Orange County (949-451-3895, tfarrell@gibsondunn.com)
Deborah A. Cussen - San Francisco (415-393-8226, dacussen@gibsondunn.com)

Crisis Management Expertise
Theodore J. Boutrous, Jr. - Los Angeles (213-229-7804, tboutrous@gibsondunn.com)

Bankruptcy Law Expertise
Michael Rosenthal - New York (212-351-3969, mrosenthal@gibsondunn.com)
David M. Feldman - New York (212-351-2366, dfeldman@gibsondunn.com)
Oscar Garza - Orange County (949-451-3849, ogarza@gibsondunn.com)
Craig H. Millet - Orange County (949-451-3986, cmillet@gibsondunn.com)
Thomas M. Budd - London (+44 20 7071 4234, tbudd@gibsondunn.com)
Gregory A. Campbell - London (+44 20 7071 4236, gcampbell@gibsondunn.com)
Janet M. Weiss - New York (212-351-3988, jweiss@gibsondunn.com)
Matthew J. Williams - New York (212-351-2322, mjwilliams@gibsondunn.com)
J. Eric Wise - New York (212-351-2620, ewise@gibsondunn.com)

Tax Law Expertise
Arthur D. Pasternak - Washington, D.C. (202-955-8582, apasternak@gibsondunn.com)
Paul Issler - Los Angeles (213-229-7763, pissler@gibsondunn.com)
J. Nicholson Thomas - Los Angeles (213-229-7628, nthomas@gibsondunn.com)
Jeffrey M. Trinklein - New York (212-351-2344, jtrinklein@gibsondunn.com)

Romina Weiss - New York (212-351-3929, rweiss@gibsondunn.com)
Benjamin H. Rippeon - Washington, D.C. (202-955-8265, brippeon@gibsondunn.com)

Executive and Incentive Compensation Expertise
Stephen W. Fackler - Palo Alto (650-849-5385, sfackler@gibsondunn.com)
Charles F. Feldman - New York (212-351-3908, cfeldman@gibsondunn.com)
Michael J. Collins - Washington, D.C. (202-887-3551, mcollins@gibsondunn.com)
Sean C. Feller - Los Angeles (213-229-7579, sfeller@gibsondunn.com)
Amber Busuttil Mullen - Los Angeles (213-229-7023, amullen@gibsondunn.com)

Broker-Dealer and Investment Adviser Compliance Expertise
K. Susan Grafton - Washington, D.C. (202-887-3554, sgrafton@gibsondunn.com)
Barry Goldsmith - Washington, D.C. (202-955-8580, bgoldsmith@gibsondunn.com)
George Schieren - New York (212-351-4050, gschieren@gibsondunn.com)
Mark K. Schonfeld - New York (212-351-2433, mschonfeld@gibsondunn.com)

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