S. 3217
Senate Banking Reform Bill

(AS REPORTED TO THE SENATE ON APRIL 15, 2010)

FINANCIAL REFORM: 2010

Working Summary No. 1

WASHINGTON REPORT ON FINANCIAL INSTITUTIONS

Gibson, Dunn & Crutcher LLP
Financial Institutions Group
www.gibsondunn.com

April 23, 2010

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 over $50 billion; 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 and Robert C. Eager**

C.F. Muckenfuss, III (202) 955-8514 *cmuckenfuss@gibsondunn.com*	Michael Bopp (202) 955-8256 *mbopp@gibsondunn.com*	Kimble Charles Cannon (213) 229-7084 *kcannon@gibsondunn.com*
K. Susan Grafton (202) 887-3554 *sgrafton@gibsondunn.com*	Adam Chen (212) 351-2327 *achen@gibsondunn.com*	Dana H. Hamada (212) 351-4064 *dhamada@gibsondunn.com*
Caeli Higney (202) 955-8542 *chigney@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*
Michael Aaron Titera (213) 229-7559 *mtitera@gibsondunn.com*	* Robert C. Eager is a retired former Gibson, Dunn & Crutcher LLP partner currently with Potomac Banking Consulting, (202) 955-8544, *reager@retiredpartner.gibsondunn.com*.	

TABLE OF CONTENTS

TABLE OF CONTENTS *(continued)*

Page

TABLE OF CONTENTS *(continued)*

Page

TABLE OF CONTENTS *(continued)*

Page

TABLE OF CONTENTS *(continued)*

Page

TABLE OF CONTENTS *(continued)*

Page

TABLE OF CONTENTS *(continued)*

Page

TABLE OF CONTENTS *(continued)*

Page

TABLE OF CONTENTS *(continued)*

Page

TABLE OF CONTENTS *(continued)*

Page

TABLE OF CONTENTS *(continued)*

Page

TABLE OF CONTENTS *(continued)*

Page

INTRODUCTION

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 as the "Restoring American Financial Stability Act of 2010." It subsequently was reported to the Senate as Senate Bill 3217 (posted on the Committee's website on April 15, 2010). The Senate Bill has been, and will continue in the near term to be, the subject of much public debate and partisan negotiation.

The attached memorandum provides a comprehensive summary of all the provisions of the bill as now being considered in the Senate. While following the titles in this bill in order, this memo also seeks to provide a topical approach that we hope makes its provisions more understandable. To facilitate further analysis, each paragraph includes section and page number references to the provision being discussed, as well as a section and page reference to provisions covering the same substantive areas in H.R. 4173, the "Wall Street Reform and Consumer Protection Act of 2009," passed by the House of Representatives on December 11, 2009.

The Senate Bill is the latest in a series of financial reform legislative efforts that began on June 17, 2009, when the U.S. Department of the Treasury released a white paper titled "Financial Regulatory Reform - A New Foundation: Rebuilding Financial Supervision and Regulation." That paper discussed forthcoming Obama Administration ("Administration") financial reform proposals based on its 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.

The House Financial Services Committee acted next, beginning with a proposal that used the Administration proposals as its starting point. As marked-up in that Committee and subsequently passed by the House as H.R. 4173 in December 2009, this legislation became different from the Administration's original proposal in significant ways. In addition, in November 2009, Chairman Christopher Dodd of the Senate Banking Committee released a bill that took different approaches from both the Administration proposal and H.R. 4173.

On March 15, 2010, Chairman Dodd released a revised version of his reform legislation. Modified at mark-up a week later by only a Managers Amendment, it was adopted on a party-line vote by the Senate Banking Committee. Among other things, the Senate Bill would:

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

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

- 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;

- Merge the Office of Thrift Supervision with the Office of the Comptroller of the Currency and arrange for the transfer of functions and transfer supervision of regional and smaller bank and thrift holding companies to the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation;

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

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

Note that page number references to the "Senate Bill" are to the version of "S. 3217" introduced in the Senate on April 15, 2010. The memorandum aims to provide a topical summary of the financial reform legislation and includes a substantive, comprehensive summary of all major Senate Bill provisions. It also includes page number references to provisions covering the same substantive areas in H.R. 4173, the "Wall Street Reform and Consumer Protection Act of 2009," 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 similar or related provision.

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 would be able to determine which United States and foreign nonbank financial companies would 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. Further, all bank holding companies with over $50 billion in total consolidated assets would be subject to the Fed's supervision. 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 Fed oversight and stricter prudential regulations if it was deemed necessary to mitigate risk to the financial system. The Council's authority under the Senate Bill, however, would be limited to those bank holding companies 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).**[1]

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. 53**); **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) (p. 26).**

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;

---

[1] Note that page number references contained herein to the Senate Bill are to the draft of the Bill introduced in the Senate by the Senate Banking Committee on April 15, 2010 and 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, pursuant to § 113;

- 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. 26-30); H.R. 4173 § 1001(c) (pp. 27-29).**

The Council would meet at least quarterly, or more frequently as the Chairman deems necessary. All Council decisions would need to be agreed to by a majority of the total voting membership of the Council. **Senate Bill § 111(f) (p. 24); H.R. 4173 § 1004 (pp. 31-32).** However, the Senate Bill specifies specific circumstances, such as the determination that a nonbank company should be subject to the Fed's supervision, which 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).**

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) (pp. 33-34); H.R. 4173 § 1006(a).**

B. Office of Financial Research

1. Structure of the Office

Senate Bill § 152 would establish within 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) (p. 63).** 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. 63).** This section would further grant the Director authority to manage personnel and to fix the number of Office employees. **Senate Bill §§ 152(b)(5) and (d)(1) (p. 64).** The Director, in consultation with the Chairperson, would have authority to establish an annual budget for the Office. 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(c) (p. 64) and 152(g)(1) (p. 66).**

Section 152 further provides that any department or agency of the United States may provide services, funds, facilities, staff, and other support services to the Office, as the Office would determine advisable. Federal government employees may also be detailed to the Office without reimbursement. **Senate Bill § 152(e) (p. 65).**

This section also contains a non-compete clause, whereby a former employee of the Office who, during the course of his or her employment, had access to any data or confidential information would be prohibited from providing consulting services to a financial company for at least one year post-employment. **Senate Bill § 152(h) (pp. 66-67).**

The Office, in consultation with the Chairperson, would also be authorized to establish a fellowship program. **Senate Bill § 152(j) (p. 67).**

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) (pp. 67-68).

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)-(f) (pp. 68-71).**

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) (pp. 71-72).**

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. 72).** 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) (p.72).** 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. 73-74).**

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. 75-76).

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) (p. 76).**

5. Funding

This section would also create a mechanism to fund the Office 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. 77-78).** 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) (pp. 78-79).** 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. 79).**

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) (pp. 79-80).** 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. 80-82).** The reporting requirement would terminate five years after the enactment of this Act. **Senate Bill § 156(c) (p. 82).**

C. Companies and Activities Subject to Stricter Prudential Standards

1. Council Authority to Apply Stricter Prudential Standards

Under the Senate Bill, all bank holding companies with assets over $50 billion would be subject to enhanced standards under § 115. (The Fed would have the authority to raise 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. 33-34); H.R. 4173 § 1103(a) (pp. 46-47).**

For purposes of the Senate Bill, a "nonbank financial company" would include both United States and foreign institutions and would be defined as a company or other entity:

(1) incorporated or organized under the laws of the United States or any state or in a country other than the United States;

(2) that is substantially engaged in, including through a branch in the United States, activities in the United States that are financial in nature, as defined in § 4(k) of the Bank Holding Company Act of 1956 (the "BHC Act"). **Senate Bill §§ 102(a)(3)(A)-(B) (pp. 19-20).**

Under Senate Bill § 102(b), the Fed would be required to establish, by regulation, the criteria for determining whether a company is "substantially engaged in activities in the United States that are financial in nature" as defined in BHC Act § 4(k) for purposes of this definition. **Senate Bill § 102(b) (p. 21).**

Section 113(a) further directs that each determination made with respect to a nonbank financial 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;
- 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)-(J) (pp. 33-34); H.R. 4173 § 1103(b) (pp. 46-49).**

2. Information Gathering by the Council

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. 30); 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) (pp. 30-31).** 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) (p. 31); 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) (pp. 31-32).**

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) (p. 32); 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) (pp. 32-33).**

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

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(d)(1) (p. 37); 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(d)(2) (pp. 37-38).**Within 30 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(d)(3) (p. 38).**

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(d)(4) (p. 38).**

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(e)(1) (pp. 38-39).** When such a waiver is granted, the Council would be required to provide notice to the company within 24 hours. **Senate Bill § 113(e)(2) (p. 39).** 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(e)(3) (p. 39).** 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(e)(4) (p. 39-40).**

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(f) (p. 40).** 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(g) (pp. 40-41); H.R. 4173 § 1103(e) (p. 50).**

4. End of Designation of Heightened Prudential Scrutiny

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(c)(1)-(2) (pp. 36-37); H.R. 4173 § 1108 (p. 116).**

5. 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. 41).**

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

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. 41-42).** 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. 42).**

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. 42-43).

7. 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. 43-44); 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. 43).** 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. 92); H.R. 4173 § 1104(a)(5) (p. 62).**

8. Contingent Capital Study by the Council

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)-(c)(3) (pp. 44-47); 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) (pp. 44-45).** 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) (p. 45).**

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) (p. 46).** Section 165(c) would grant the Fed authority to promulgate appropriate regulations to enforce such requirements. **Senate Bill § 165(c)(1) (pp. 93-94).** 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) (pp. 46-47) and 165(c)(2)(A)-(E) (pp. 94-95).

9. Resolution Plan and Credit Exposure Reports

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) (p. 47).** 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) (pp. 47-48); H.R. 4173 §§ 1104(f)(1) and (2) (pp. 96-97).**

10. 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) (p. 48). Section 165(e)(1) would direct the Fed to prescribe standards that limit such risks. **Senate Bill § 165(e)(1) (pp. 98-99).**

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[2] 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. 99).**

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. 101).** The Fed would also have the option of extending the transition period for an additional two years. **Senate Bill § 165(e)(7)(B) (p. 101); H.R. 4173 § 1104(c) (pp. 66-69).**

11. 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. 48).**

12. 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

---

[2] 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. 99-100).**

- 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. 48-49).**

13. 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) (p. 55).**

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. 55).** 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. 56); 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) (p. 57).** 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. 57).**

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. 58).** 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. 58-59); 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. 90-91).**

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. 91-92).**

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. 93-95).**

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. 99).** The term "credit exposure" is defined broadly in the Senate Bill. **Senate Bill § 165(e)(3) (pp. 99-100).**

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. 92-93).**

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. 101).**

5. 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. 101).**

6. 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. 102-104).**

7. 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. 104).**

8. 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. 82-84).**

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) (p. 83).** 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) (pp. 83-84).** A nonbank financial company supervised by the Fed would be required to provide this information upon request. **Senate Bill § 161(a)(3) (p. 84).** 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. 85).** The Fed is further directed to avoid duplicate examination activities and requests for information. **Senate Bill § 161(c)(2) (p. 85).**

9. 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) (pp. 85-86).** 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) (p. 86).**

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) (pp. 86-87).**

10. 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. 95-98).**

11. 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) (p. 59).** 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) (p. 59).**

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. 61).**

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. 61).**

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) (pp. 59-60).** Written notice must include an explanation for the Fed's consideration of such action. **Senate Bill § 121(b)(1) (pp. 59-60).** 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) (p. 60).**

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. 60).**

12. Early Remediation Requirements

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. 104-105).**

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) (pp. 105-106).**

13. 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) (p. 109).** 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) (pp. 109-110).** 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) (p. 110).**

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

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) (p. 106).**

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

a) Financial Activities

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 could 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) (pp. 106-107).** 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. 107).**

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.

b) Affiliate Transactions

Further, 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, if 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) (p. 108); H.R. 4173 §§ 1301(b)(2)(C) (pp. 208-209) and 1301(c) (pp. 223-224).**

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) (p. 135).** 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 dissolution 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 Bankruptcy 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 also contains provisions for resolving failing and failed bank holding companies.

B. Qualifications for a CFC

1. Orderly Liquidation Regime Applicable to Financial Companies

The Senate Bill's dissolution regime would apply to a "financial company," as defined by Section 201(11), 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 Fed under the Senate Bill;

- any 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 a subsidiary that is an insured depository institution or insurance company; and

that is not a Farm Credit System institution. **Senate Bill § 201(10) (pp. 113-114)**; **H.R. 4173 § 1602(9) (pp. 328-330).**

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. 134-135); H.R. 4173 § 1602(9) (pp. 328-330).**

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 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 United States 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. 125-129); H.R. 4173 § 1603 (pp. 331-333).**

If the above standards are met, the Secretary would then petition the newly created Orderly Liquidation Authority Panel (the "Panel"), a three judge panel composed of Bankruptcy

Judges from the District of Delaware, for an order authorizing the Secretary to appoint the FDIC as receiver of the financial company. If the Panel finds the Secretary's determination is supported by "substantial evidence," the Panel 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 not supported by substantial evidence, the Panel 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. Once the order is granted, the FDIC, as receiver, would resolve the CFC under the Orderly Liquidation Authority. **Senate Bill § 202(a) and (b) (pp. 115-121).** If the CFC is a broker-dealer ("covered brokers and dealers" or "CBDs") 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. 138); H.R. 4173 § 1602(9) (pp. 328-330).**

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. 147-153); H.R. 4173 § 1609(a) (pp. 346-356).**

Unlike 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 a 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 continues in this capacity the debtor is known as the debtor-in-possession (the "DIP"). Upon the occurrence of certain events, the debtor in possession 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 new Orderly Liquidation Fund. **Senate Bill § 204(d) (pp. 137-138).** The FDIC would have exclusive authority (with some oversight by the Secretary of the Treasury) to impose *ex ante* assessments on "eligible financial companies." "Eligible financial companies" would be defined as bank holding companies with total consolidated assets of at least $50 billion and non-bank financial companies supervised by the Fed. Such companies would be assessed starting one year after the enactment of the Senate Bill for five to ten years, as determined by the FDIC, until the Fund reaches $50 billion in size.

After the Fund reaches $50 billion, assessments would be suspended but could be resumed if (a) the Fund falls below the target size after the initial capitalization period, (b) the FDIC is appointed as receiver for a CFC and the Fund incurs a loss during the initial capitalization period or (c) the FDIC determines that such assessments are necessary to pay in full the obligations issued by the FDIC to the Secretary within 60 months of the issuance of the obligations. When any of the above occurs, assessments would be imposed on eligible financial companies and financial companies with total consolidated assets equal to or over $50 billion. In addition, companies who have received payments or credit from the (i) dissimilar treatment of similarly situated creditors, (ii) the FDIC's determination that such payment is necessary to minimize losses to the FDIC from the liquidation of the CFC or (iii) dissimilar treatment of similarly situated creditors in the FDIC's transfer of CFC assets or liabilities to a Bridge Company under the Senate Bill would be assessed at a substantially higher rate. The Fund would be replenished through such assessments and the proceeds received under the liquidation of CFCs.

The FDIC would be authorized raise additional funds by borrowing from the Secretary. But the FDIC could borrow from the Secretary only after the cash and cash equivalents held by the Fund have been "drawn down." Once this has occurred, the FDIC, as receiver, could issue debt obligations to the Secretary who can sell such obligations through public debt transactions. The FDIC could not issue obligations if the aggregate amount of such obligations outstanding exceeds the sum of cash or cash equivalent held by the Fund and 90% of the assets of each CFC that are available to repay the FDIC.

Under the Senate Bill, the FDIC could require financial companies to make information available to it, so that it can determine the scope of 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. **Senate Bill § 210(n) and (o) (pp. 276-289); 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 Bankruptcy 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. 246); 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 would provide for judicial review of the Secretary's determination to commence the Orderly Liquidation Authority by the Panel. The Secretary would be required to petition the Panel to appoint the FDIC as receiver under the Senate Bill, and the CFC is given notice of such petition and an opportunity to be heard by the Panel. The Panel would be required to make its decision within 24 hours of receipt of the petition. 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 such decision to the United States Court of Appeals for the Third Circuit, provided, however, that the Court of Appeals would not have jurisdiction to hear any appeal by a financial company if it acquiesced or consented to the appointment of a receiver by the Secretary. A petition for *writ of certiorari* to review a decision by the Court of Appeals could be filed with the Supreme Court no later than 30 days after the date of the final decision of the Court of Appeals. **Senate Bill § 202 (pp. 115-122); H.R. 4173 § 1605 (p. 343).**

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. 165); 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. 158-165); 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. 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 which 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 which 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 Bankruptcy 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 Resolution 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) (pp. 163-164), 210(c)(12) (p. 128) and 210(d) (pp. 243-246); H.R. 4173 §§ 1609(a)(4)(D) (pp. 360-364) and 1609(c)(12) (pp. 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. 270-272); 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. 140-141).**

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 the FDIA. Unsecured claims would have the following priority, in descending order:

- administrative expenses of the receiver;
- any amounts owed to the United States;
- general or senior liabilities of the CFC;
- obligations subordinated to general creditors;
- obligations to persons with interests in the equity of the CFC as a result of their status as a shareholder, member, etc.

As seen above, the Senate Bill would give priority to claims of the United States against the CFC (such as for assistance payments) over other unsecured creditors. 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. 191-195); 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(1) (pp. 110-111); 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) (p. 244); H.R. 4173 § 1609(d)(2) (pp. 431-432).**

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 there are some court-enacted doctrines that enable a debtor to pay prepetition creditors that are 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 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 just like any other general unsecured claim, while 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 covered financial company 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) (p. 244); 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 covered broker or dealer. 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. 141-143).**

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 D&O 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. 195-243); 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 is in (a) writing, (b) 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. 169-170); 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 fifth 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 which is not the subject of a receivership, bankruptcy or other insolvency proceeding. 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 its 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 a party's status as a non-defaulting party, would not be enforceable under the Senate Bill.

Under the Senate, 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. 205-238); 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 Bankruptcy 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 provide 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 the 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. 248-272); 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 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. It is unclear what actions would constitute "in contemplation of insolvency." **Senate Bill § 210(c)(12) (p. 238); 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. 176-183).**

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 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 covered financial company 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 covered financial company 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 he 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. 176-183); H.R. 4173 § 1609(a)(12) (pp. 376-382).**

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 a 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, the Bill 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) who 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 setoff, 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 which 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. 183-187).**

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 setoff 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. 138-143).** The Senate Bill sets the maximum liability for a customer of a CBD at the amount the customer would have received from their 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) (pp. 244-245).**

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 a 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 a CFC. **Senate Bill § 206 (pp. 143-144).**

15. 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. In addition, under the Senate Bill, 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 also be required to conduct a study regarding international coordination relating to the liquidation of financial companies under the Bankruptcy Code.

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. The Senate Bill would abolish the OTS and transfers its functions to the Fed, the OCC, and the FDIC. Further, the Senate Bill would transfer some of the Fed's functions related to bank holding companies to 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 (pp. 295-296).**

The division of OTS' functions is somewhat different in the Senate Bill than 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

a) Holding Companies Over $50 Billion

The Senate Bill would transfer all functions and powers of the OTS relating to the supervision of any savings and loan holding company with more than $50 billion in total consolidated assets[3] and any subsidiary of such company to the Fed. **Senate Bill § 312(b)(1)(A) (pp. 298-299).**

b) Holding Companies Under $50 Billion

The Comptroller of the Currency would assume the OTS's functions related to the supervision of (1) savings and loan holding companies having less than $50 billion in total consolidated assets and having an insured Federal depository institution subsidiary, or both Federal and State insured depository institution subsidiaries, where the Federal depository institution(s)'s assets exceed those of the State depository institution(s), and (2) any other

---

[3] Total consolidated assets will be determined under regulations to be promulgated by the OCC, the Corporation, and the Board no later than 180 days after the Act is enacted. **Senate Bill § 312(e).**

subsidiary of such savings and loan holding company other than a depository institution. **Senate Bill § 312(b)(1)(B) (pp. 299-300); H.R. 4173 §§ 1204(a) and 1256 .**

The FDIC would assume the OTS's functions related to the supervision of (1) savings and loan holding companies with less than $50 billion in total consolidated assets and having an insured State depository institution subsidiary or both Federal and State insured depository institution subsidiaries, where the State institution(s)'s assets exceed those of the Federal institution(s)'s, and (2) any other subsidiary of such savings and loan holding company. **Senate Bill § 312(b)(1)(C) (pp. 300-301).**

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)(A) (pp. 294-295).** 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) (pp. 301-302).**

The Senate Bill would, however, amend the Home Owners' Loan Act by adding a section that requires the Fed to consult with the Comptroller and the FDIC as to regulations that apply to savings and loan holding companies with less than $50 billion in total consolidated assets. Additional amendments require that the Comptroller consult with the FDIC as to the terms of regulations relating to State savings associations. **Senate Bill § 312(d)(4) (pp. 313-314).**

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) (p. 302).**

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. 302).**

2. Rulemaking Authority Over Savings Associations

The Senate Bill provides that the Comptroller of the Currency and FDIC would assume, and jointly exercise, rulemaking authority relating to savings associations. **Senate Bill § 312(c)(1)(C) (p. 305); H.R. 4173 § 1204(a).**

C. Supervision of Bank Holding Companies Under $50 Billion

1. BHC with Federal Depository Institution Subsidiary

The Senate Bill provides that the Office of the Comptroller of the Currency (OCC) would assume all functions of the Fed (including any federal reserve bank) related to the supervision of (1) any bank holding company with less than $50 billion in total consolidated assets and having a

subsidiary that is an insured Federal depository institution or, if it has both Federal and State depository institution subsidiaries, only where the assets in the Federal depository institution(s) exceed those in the State depository institution(s); and (2) any subsidiary of such a bank holding company. **Senate Bill § 312(c)(1)(A) (pp. 303-304).**

2. BHC with State Depository Institution Subsidiary & State Member Banks

The FDIC will assume functions of the Fed relating to the supervision of (1) any bank holding company having less than $50 billion in consolidated assets and having a subsidiary that is an insured State depository institution or has both Federal and State depository institution subsidiaries, only where the assets in the State depository institutions exceed those in the Federal depository institutions; and (2) any subsidiary of such a bank holding company. **Senate Bill § 312(c)(1)(B) (pp. 304-305).**

The Senate Bill also transfers all functions of the Fed relating to the supervision of insured State member banks to the FDIC, with the exception of rulemaking authority under the Federal Reserve Act. **Senate Bill § 312(c)(2) (pp. 305-306).**

3. Rulemaking Authority with Respect to BHCs

None of the Fed's rulemaking authority with respect to bank holding companies would be transferred to either the OCC or the FDIC. **Senate Bill § 312(c)(1)(C) (p. 305).**

The Senate Bill would, however, amend BHC Act § 5 by adding a section regarding consultation in rulemaking. Before proposing or adopting regulations under the Act that apply to bank holding companies with less than $50 billion in total consolidated assets, the Fed would be required to consult with the Comptroller and the FDIC as to the terms of such regulations. **Senate Bill § 312(d)(3) (pp. 312-313).**

D. 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; any bank-holding company for which it has assumed supervisory power (see above); any bank holding company subsidiary (other than a depository institution); any Federal savings association, any savings and loan holding company for which it has assumed supervisory power (see above); and any savings and loan holding company subsidiary (other than a depository institution). **Senate Bill § 312(d)(1) (pp. 306-311); 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; any State savings association; any bank holding company for which it has assumed supervisory power (see above); any bank

holding company subsidiary (other than a depository institution); any savings and loan holding company for which it has assumed supervisory power (see above); and any savings and loan holding company subsidiary (other than a depository institution). **Senate Bill § 312(d)(1) (pp. 306-311); 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 non-insured 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 with total consolidated assets of more than $50 billion and its subsidiaries (other than depository institutions); and any savings and loan holding company with total consolidated assets of more than $50 billion and its subsidiaries. **Senate Bill § 312(d)(1) (pp. 306-311); H.R. 4173 § 1204(b).**

References in the BHC Act would be amended to affect these changes. **Senate Bill § 312(d)(2) (pp. 311-312).**

E. 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(d)(4) (pp. 313-315).**

F. 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. 296); 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. 296-298); H.R. 4173 § 1205(b) .**

G. Establishment of the Office of the Comptroller of the Currency

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. 319); H.R. 4173 § 1207.**

2. Office of the Comptroller of the Currency

Under the Senate Bill, the Office of the Comptroller of the Currency (OCC) would be a new bureau residing 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." 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. The Comptroller would have same authority as was previously vested in the Director of OTS. The OCC would vest upon the transfer date, and Section 324 of the Revised Statutes of the United States would be amended to this end. **Senate Bill § 314 (pp. 319-321).**

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. 321); 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) (p. 322); H.R. 4173 § 1208(a)(2).**

b) Existing Rights, Duties, and Obligations of Fed Not Affected

Likewise, the transfer of powers away from the Fed would not affect the validity of any right, duty, or obligation of the United States, the Fed, any Federal reserve bank or any other person. Nor would it abate any action or proceeding arising out of a function of the Fed that is

transferred to the OCC or the FDIC, except the appropriate party shall be substituted for the Fed. **Senate Bill § 316(b) (pp. 322-323).**

c) 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, a court of competent jurisdiction, or the operation of law. **Senate Bill § 316(c) (pp. 323-325); H.R. 4173 § 1208(b).**

d) 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. The FDIC would need to do the same with respect to the regulations that relate to State savings associations. 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(d) (pp. 325-326); H.R. 4173 § 1208(d).**

Regulations that have been proposed by the OTS or Fed 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(e) (pp. 326-327); H.R. 4173 § 1208(e) – (f).**

e) 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. With regard to the Fed, any reference to the Fed or any Federal reserve bank in connection with any power of the Fed's transferred would be deemed a reference to the Comptroller of the Currency, the OCC, the Chairperson of the FDIC, or the FDIC, as appropriate. **Senate Bill § 317 (pp. 327-328).**

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. **Senate Bill § 318(a)(1) (pp. 328-330).**

Further, the Comptroller would be required to submit to the Board of Directors of the FDIC a proposal to promote parity in examination fees paid by State and Federal depository institutions with assets totaling less than $50 billion. The Board of Directors of the FDIC would vote on the proposal and then promptly implement a plan to periodically transfer a percentage of the funds the OCC estimates necessary to carry out its responsibilities related to the supervision of Federal depository institutions with assets of less than $50 billion. **Senate Bill § 318(a)(2) (pp. 330-332).**

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) (p. 333).**

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) (p. 324).**

These amendments would take effect on the transfer date. **Senate Bill § 318(d) (p. 324).**

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)**.

See pp. 335-366. H.R. 4173 §§ 1210-1217 (pp. 157-178) contains similar provisions**.**

H. 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) (pp. 366-367).**

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 the average long -term unsecured debt of the insured depository institution during the assessment period. If, however, the FDIC finds that this amendment would reduce the effectiveness of the risk-based assessment system or increase the risk of loss to the Deposit Insurance Fund, the FDIC could continue the currently existing definition of assessment base or adopt a new definition as appropriate. **Senate Bill § 331(b) (pp. 367-368).**

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 (pp. 368-369); H.R. 4173 § 1221.**

I. 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. 369-370).**

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 (pp. 370-371).**

TITLE IV — REGULATION OF ADVISERS TO HEDGE FUNDS AND OTHERS

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. 373); 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. 371); 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. 382). 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. 373); 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. 371-372).**

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. 373); 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. 373-374); 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. 383); 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. 383-384).**

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. 384-385).**

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. 384); 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. 384-385)**; (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. 374-375); 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. 375-376); 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. 375-379);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. 377-381); 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. 381); 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. 382); 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. 386).** 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 financial threshold for an accredited investor as defined by the SEC under the Securities Act of 1933 (the 1933 Act), by calculating an amount that is greater than the amount in effect on the date of enactment of the Senate Bill of $200,000 income for a natural person (or $300,000 for a couple) and $1 million in assets, as the SEC determines appropriate and in the public interest, in light price inflation since those figures were determined. The SEC would be required to adjust that threshold at least once every five years to reflect the percentage increase in the cost of living. **Senate Bill § 412 (pp. 386-387).**

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. 389); 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. 387).**

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. 387-388).**

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. 388).**

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. These provisions largely mirror those governing the Federal Insurance Office 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 established as 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 (p. 389-390).**

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;[4]

---

[4] "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. 390-392).**

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. 392-396).**

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 (p. 396-400).**

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 (p. 401).**

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. 401-404).**

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 (pp. 406-408).**

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. 408).**

1. Nonadmitted Insurance[5]

Under Subtitle B of Title V, no state other than the home state[6] 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. 408-410).**

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

---

[5] 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.

[6] 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. 410-411).**

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. 412-413).**

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. 413-415).**

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.[7] Namely, the Bill provides that if the domiciliary state[8] 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) (pp. 423-424).** 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. 424-425).**

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. 425-426).**

---

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

[8] 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.[9] **Senate Bill § 603(a)(4) (p. 430).** 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. 428).** 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) (p. 428-430).** 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. 430);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

---

[9] 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. 428-429).**

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. 432-434).**

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. 434-435).**

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. 435).** 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) (pp. 435-436).** 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) (p. 436)**; **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) (p. 436-437).** 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) (p. 436-439)**.

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. 441-443).** 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. 441-443).**

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. 441-443).**

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) (p. 439).**

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) (p. 432-433).** 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. 86-87).** 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) (pp. 86-87).**

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) (pp. 439-440)**; **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) (pp. 87-88)**.

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. 440); 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. 441-442).** 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. 87-88).**

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. 446-451).**

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 (pp. 446-451).** The Senate Bill provides guidance for calculating "total consolidated assets," referring to FDI Act § 3(q). **Senate Bill § 605 (pp. 446-451).**

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 (pp. 446-451).** 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. 446-451).**

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. 446-451).**

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. 452-455)**; **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. 453-461).** 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. 453-461).**

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. 453-461).** 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 (p. 453-461).**

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. 453-461).**

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. 453-461).**

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. 453-461).** 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. 453-461).**

The Bill amends 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. 453-461).**

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. 453-461).**

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 (p. 461).** 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. 463-465); 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. 465); 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. 468-469); 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. 469-470).**

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. 465-466); 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. 466-567); 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. 470-471).**

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. 473)**; **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) (pp. 474-476). 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. 473-475).** 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. 475-480).** 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) (pp. 479-480).** 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)(pp. 480-482)**.

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[10] 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. 483).** 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. 484-485).**

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

---

[10] 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) (p. 483-485).**

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) (p. 483-485).**

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) (p. 489--490).**

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) (p. 490-491).**

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)) (p. 491-495).** 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) (p. 491-495).**

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 (p. 496-500); 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

A. Overview

1. Congressional Findings Regarding Over-The-Counter Derivatives Markets

Under Title VII, the "Over-the-Counter Derivatives Markets Act of 2010," Congress makes a number of findings regarding the global over-the-counter (OTC) derivatives market. The OTC derivatives market has grown from $91 trillion in 1998 to $592 trillion in 2008 according to the Bank for International Settlements. Many concerns were raised during the financial crisis because of the interconnectedness of firms and their counterparty exposures to each other. Taxpayers paid a substantial sum because firms held insufficient margin and capital.

Though derivatives can help manage risk, they can also increase risk because they allow market participants to take large positions based on a small amount of capital. The OTC system allows the counterparties to set their own margin requirements, which does not require them to take into account the risk posed to the rest of the financial system. Credit markets froze because market participants feared the viability of their counterparties and the safety of their assets. Lack of transparency hindered regulators and made resolution of OTC positions more expensive for taxpayers, according to the Bill. Bilateral derivatives contracts should be permitted, but all derivatives activities should be regulated with appropriate risk management and prudential standards.

The derivatives market lacks reliable transaction information, which hampers oversight of the market says Congress. Clearing derivatives contracts will provide more information and will reduce costs and risks. Exchange-trading of derivatives should be encouraged because it will offer more price transparency, efficiency, and liquidity.

Finally, the findings note that the Group of 20 nations have agreed that, by the end of 2012, all standardized OTC derivatives should be traded on exchanges or electronic trading platforms where appropriate and cleared through central counterparties; OTC derivatives should be reported to trade repositories; and non-cleared contracts should be subject to higher capital requirements. **Senate Bill § 702(a) (pp. 500-504).**

2. Purposes of Regulation

The purposes of Title VII include establishing well-regulated derivatives markets, promoting the public interest and protecting investors and market participants, as well maintaining fair and orderly markets to assure prompt and accurate clearance of derivatives transactions, prompt and accurate reporting to regulators and trade repositories, publicly available trading information, efficient execution of transactions in swaps and security-based swaps, and fair competition among derivatives markets.

Because much of the regulation of swap markets (outlined in Subtitle A) and regulation of security-based swap markets (outlined in Subtitle B) proposed under the Senate Bill parallel

each other, this portion of the memorandum addresses regulation of both types of markets together to avoid redundancy. Distinctions in their regulation, however, are noted. To avoid redundancy, where applicable, the term "[security-based] swap" refers to both swaps and security-based swaps. The "relevant Commission" for swaps refers to both the CFTC and, for security-based swaps, the SEC. **Senate Bill § 702(b) (pp. 500-504).**

3. Effective Date

The Title shall take effect 180 days after its enactment. **Senate Bill § 765 (p. 736).**

4. Definitions

Title VII would amend the Commodity Exchange Act (7 U.S. Code § 1a) and the Securities Exchange Act of 1934 (15 U.S. Code § 78c(a)) by adding new definitions and updating existing definitions, including:

a) Swap

The term "swap" would be defined to mean any agreement, contract, or transaction that:

(i)is "a put, call, cap floor, collar or similar option of any kind for the purchase or sale of, or based on the value of, one or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind;"

(ii) "provides for any purchase, sale, payment, or delivery (other than a dividend or equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence;"

(iii) "provides on an executory basis for the exchange, on a fixed or contingent basis, of 1 or more payments based on the value or level of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof" and that transfers between the parties the financial risk associated with future changes in the value or level without conveying a current or future direct or indirect ownership interest in an asset or liability, including any "agreement, contract, or transaction commonly known as an interest rate swap, a rate floor, rate cap, rate collar, cross-currency rate swap, basis swap, currency swap, total return swap, equity index swap, equity swap, debt index swap, debt swap, credit spread, credit default swap, credit swap, weather swap, energy swap, metal swap, agricultural swap, emissions swap, or commodity swap";

(iv) "is, or in the future becomes, commonly known to the trade as a swap"; or

(v) "is any combination or permutation of, or option on, any agreement, contract, or transaction described in any of [these clauses]".

The Title specifically excludes from the term "swap":

> (i) any contract of sale of a commodity for future delivery or security futures product traded on boards of trade designated as a contract market;
>
> (ii) any sale of a nonfinancial commodity or any security for deferred delivery, so long as it is physically settled;
>
> (iii) "any put, call, straddle, option, or privilege" on any security, certificate of deposit, or group of index of securities;
>
> (iv) "any put, call, straddle, option, or privilege relating to foreign currency entered into on a national securities exchange";
>
> (v) any transaction providing for the purchase or sale of one or more securities on a fixed basis;
>
> (vi) any transaction providing for the purchase or sale of one or more securities on a contingent basis, unless the transaction predicates the purchase or sale on the occurrence of a contingency that may be expected to affect or be affected by the creditworthiness of a party other than a party to the transaction;
>
> (vii) any note, bond, or evidence of indebtedness defined as a security under the Securities Act of 1933;
>
> (viii) any transaction based on a security and entered into directly or through an underwriter by the issuer of the security to raise capital, unless the transaction is entered into to manage a risk associated with raising capital; (ix) any foreign exchange swap; (x) any foreign exchange forward;
>
> (xi) any transaction to which one counterparty is the Federal Reserve or the United States government; and
>
> (xii) any security-based swap.

Senate Bill § 711 (pp. 505-509) (amending CEA § 1a. para. 34-35).

b) Security-Based Swap

The term "security-based swap" would have the same meaning as in section 3(a)(68) of the Securities Exchange Act of 1934 (15 U.S.C. § 78c(a)(68)). **Senate Bill § 711 (p. 513).**

c) Eligible Contract Participant

The term "eligible contract participant" would have the same meaning as in Section 1a(12) of the Commodity Exchange Act (7 U.S.C. § 1a(12)). **Senate Bill § 751 (p. 634).**

d) [Security-based] Swap Dealer

The Title would add the definition of "swap dealer," defining it as "any person engaged in the business of buying and selling [security-based] swaps for such person's own account, through a broker or otherwise." The term would exclude anyone who buys or sells swaps for one's own account, but not as a part of regular business. **Senate Bill § 711 (pp. 513-514)**,

amending CEA Sec. 1a. para. 38), '34 Act Sec. 3(a)(31). The term "security based swap dealer" would have the same meaning as in section 3(a)(71) of the Securities Exchange Act of 1934.

e) Major [Security-Based] Swap Participant

The major [security-based] swap participant (MSP) definition would include any person who is not a [security-based] swap dealer and "(i) who maintains a substantial net position in outstanding [security-based] swaps, excluding positions held primarily for hedging, reducing, or otherwise mitigating commercial risk; or (ii) whose failure to perform under the terms of its [security-based] swaps would cause significant credit losses to its [security-based] swap counterparties." **Senate Bill § 711 (pp. 514-515)**, amending CEA § 1a. para 39, '34 Act § 3(a)(67).

f) Joint Rulemaking on Further Definition of Terms

The SEC and CFTC would be responsible for further defining these rules and terms no later than 180 days after the Title's effective date. When they do so, their rules should be uniform. If the agencies conflict in their rulemaking, the Financial Stability Oversight Council would resolve the conflict after consideration of the relevant information provided by each Commission and by either determining a compromise position or agreeing with one Commission. The SEC and CFTC would be required treat functionally or economically similar products similarly. Any interpretation or guidance provided under this Title would be effective only if issued jointly by the SEC and CFTC. **Senate Bill § 711(b) (pp. 517-518).**

B. Jurisdiction

Section 712 would amend CEA section 2(a)(1)(A) (7 U.S.C. § 2(a)(1)(A)) to give the CFTC jurisdiction over this Title and transactions involving swaps and contracts of sale of a commodity for future delivery. It would amend Section 2 of the CEA (7 U.S.C. § 2) to clarify that the Title shall not apply to, and the CFTC shall not have jurisdiction with respect to, "any security other than a security-based swap." **Senate Bill § 712 (pp. 520-521).**

Section 759 would amend Section 36 of the '34 Act (15 U.S.C. § 78mm) to clarify that the SEC shall not have authority to grant exemptions from the security-based swap provisions of the Act except as expressly authorized under its provisions, but is expressly authorized to exempt any person, security, or transaction from any provision of the Title if the Title applies only because a "security-based swap" is a "security." **Senate Bill § 759 (pp. 727-728).**

C. Clearing of Swaps and Security-Based Swaps

1. Repeal of Prohibition on Regulation of Security-Based Swaps

Section 752 would repeal Sections 206B and 206C of the Gramm-Leach-Bliley Act (15 U.S.C. § 78c note), removing the prohibition on the regulation of security-based swaps. It also would make conforming amendments to the Gramm-Leach Bliley Act, the Securities Act of 1933, the Securities Exchange Act of 1934. **Senate Bill § 752 (pp. 641-648).**

2. Clearing Requirement

Section 713 would repeal the CEA's prohibition on the regulation of derivative transactions and electronic trading facilities. Under Sections 713 and 753(a), it would be unlawful for anyone other than an eligible contract participant to enter into a [security-based] swap agreement unless the swap is entered into on or subject to the rules of a board of trade. The sections would add a clearing requirement providing that any person who is a party to a [security-based] swap shall submit the [security-based] swap for clearing to a registered derivatives clearing organization (or exempt DCO) or a registered clearing agency. **Senate Bill § 713(a) (pp. 521-524) and 753(a); H.R. 4173 §§ 3103(a) and 3203(a).**

The SEC, CFTC, and Federal banking agencies would be required to consult with each other prior to adopting rules with regard to security-based swaps. Within 180 days of the Title's effective date, the SEC and CFTC must jointly adopt uniform rules governing the clearing and settlement of swaps and persons registered as DCOs, and the clearing and settlement of security-based swaps and persons registered as clearing agencies. **Senate Bill § 713(a) (p. 524).**

3. Submission for Clearing and Commission Approval

The derivatives clearing organization (DCO) or clearing agency's rules would be required to prescribe that all [security-based] swaps with the same terms and conditions shall be fungible and provide for nondiscriminatory clearing of a [security-based] swap executed on or through the rules of an unaffiliated contract market, unaffiliated national securities exchange, or alternative swap execution facility (ASEF).

DCOs and clearing agencies would need to submit any type of [security-based] it seeks to accept for clearing to the CFTC or SEC. The CFTC or SEC would make the submission public and take action on the submission within 90 days unless the DCO or clearing agency agrees to an extension of time. The CFTC or SEC shall approve the type of [security-based] swap for clearing unless the relevant Commission makes a finding that the request is inconsistent with section 5b(c)(2). The CFTC or SEC must adopt rules within 180 days after the effective date of the Senate Bill for submissions.

The relevant Commission may stay the clearing requirement either based on an application by a [security-based] swap counterparty or on its own initiative until the commission reviews the terms of the [security-based] swap. The review must occur within 90 days after the issuance of the stay. The Commission may determine either unconditionally or conditionally to require that the [security-based] swap must be cleared if the Commission finds that the clearing is consistent with section 5(b)(2) for swaps or section 17A for security-based swaps and is in the public interest and for investor protection. It also may determine that the clearing requirement shall not apply to the [security-based] swap. **Senate Bill § 713(a) (pp. 524-526) and 753(a); H.R. 4173 §§ 3103(a) and 3203(a).**

4. Rules for Clearing Requirements

Under the Senate Bill, the CFTC or SEC would be required to adopt rules for reviewing a DCO or clearing agency's clearing of a [security-based] that the Commission has accepted for clearing within 180 days after the Title's effective date.

Within 180 days of the enactment date, the SEC and CFTC shall jointly adopt rules to further identify any type of [security-based] swaps not submitted for approval that the Commissions deem should be accepted for clearing. The Commissions shall consider six factors when making that determination – (i) the extent to which any terms of the type of [security-based] swap are disseminated to third parties or referenced in other transactions; (ii) the volume of transactions in the type of swap; (iii) the extent to which the [security-based] swap's terms are similar to other transactions that are centrally cleared; (iv) whether any differences from other types of [security-based] swaps that are centrally cleared are economically significant; (v) whether a DCO or clearing agency is prepared to clear the type of [security-based] swap and the DCO or clearing agency has effective risk management systems in place; and (vi) any other factors the Commissions determine to be appropriate.

All transactions that must be cleared must be executed on a board of trade designated as a contract market (for swaps) or an exchange (for security-based swaps) or executed on a registered ASEF or an ASEF exempt from registration, unless no board of trade, exchange, or ASEF makes the swap available to trade. **Senate Bill § 713(a) (pp. 526-529) and 753(a); H.R. 4173 §§ 3103(a) and 3203(a).**

5. Reporting Requirements

If a [security-based] swap is not centrally cleared, its counterparties would be required to report it 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, in an amount of time prescribed by the CFTC or SEC.

During the transition period, [security-based] swaps entered into before the date of enactment shall be reported to a registered [security-based] swap repository or the CFTC or SEC no later than 180 days after the Title's effective date; [security-based] swaps entered into on or after the date of enactment shall be reported to a registered [security-based] swap repository or relevant Commission no later than 90 days after the effective date or in an amount of time prescribed by the CFTC or SEC. **Senate Bill § 713(a) (p. 529) and 753(a); H.R. 4173 §§ 3103(a) and 3203(a).**

6. Exemptions

If reported, then [security-based] swaps entered into before the date of enactment or before the application of the clearing requirement are exempt from the clearing requirement.

The relevant Commission must exempt a [security-based] swap from clearing and exchange trading if no DCO or clearing agency will accept the [security-based] swap for clearing.

As amended by the Manager's Amendment, the relevant Commission may conditionally or unconditionally exempt a [security-based] swap from clearing and exchange trading if one of the counterparties to the [security-based] swap (i) is not a [security-based] swap dealer or MSP and (ii) does not meet the eligibility requirements of any DCO or clearing agency that clears the [security-based] swap. The relevant Commission may exempt a [security-based] swap only if the Commission has provided written notice to the Financial Stability Oversight Council

describing the proposed exemption and the Council has not made a determination and notified the Commission within 60 days of receipt of the notice that the exemption would pose a threat to the United States financial system's stability. **Senate Bill §§ 713(a) (pp. 531-533) and 753(a); H.R. 4173 §§ 3103(a) and 3203(a).**

D. Derivatives Clearing Organizations and Clearing Agencies

1. Registration Requirement

The Title would amend CEA § 5b(a) and (b) to make it unlawful for a DCO to make use of the mails or any means of interstate commerce to perform DCO functions unless registered with the CFTC. It clarifies that a DCO exempt from registration may register with the CFTC. It also states that DCOs may clear security-based swaps that are required to be cleared by a person registered as a clearing agency under the '34 Act and that clearing agencies may clear swaps that are required to be cleared by a person who is registered as a DCO under the CEA.

The Title would amend CEA § 5b by adding a requirement that any person required to be registered as a DCO must register with the CFTC regardless of whether that person is also a bank or clearing agency registered with the SEC. Similarly, any person required to be registered as a clearing agency must register with the SEC, regardless of whether that persona is a bank or registered DCO. **Senate Bill § 713(b) (pp. 533-534).**

2. Joint CFTC and SEC Rules

Not later than 180 days after the Title's effective date, the CFTC and SEC would be required to jointly adopt uniform rules governing the clearing and settlement of [security-based] swaps and persons that are registered as DCOs for swaps and clearing agencies for security-based swaps.

The SEC and CFTC must consult with the appropriate Federal banking agencies and each other prior to adopting rules with respect to swaps. **Senate Bill §§ 713(b) (p. 535) and 753(b); H.R. 4173 §§ 3103(b) and 3203(b).**

3. Exemptions

The CFTC may exempt, conditionally or unconditionally, a DCO from registration if the CFTC finds that the DCO is subject to comparable, comprehensive supervision and regulation on a consolidated basis by the SEC or appropriate governmental authorities in the organization's home country. **Senate Bill §§ 713(b) (p. 536) and 753(b); H.R. 4173 §§ 3103(b) and 3203(b).**

4. Compliance Officers

Each DCO and clearing agency must designate a compliance officer who will report to its board or senior officer; review compliance of the DCO with core principles established in section 5b(c)(2); consult with the DCO or clearing agency's board to resolve conflicts of interest; administer the DCO or clearing agency's policies and procedures; ensure compliance with the Title; and establish procedures for remedying noncompliance issues. The compliance officer must prepare and sign an annual compliance report and submit it with the DCO or clearing

agency's financial reports to the CFTC or SEC. **Senate Bill §§ 713(b) (pp. 536-538) and 753(b); H.R. 4173 §§ 3103(b) and 3203(b).**

5. Core Principles for Derivates Clearing Organizations

The Senate Bill would amend Section 5(b)(c)(2) of the CEA (7 U.S. Code § 7a-1(c)(2)) to address core principles for DCOs. DCOs must comply with the principles to maintain their registration, though DCOs will have reasonable discretion in establishing the manner in which they comply with the principles. The principles include:

- Financial Resources: Each DCO must have adequate financial, operational, and managerial resources to discharge its responsibilities. Its resources must, at minimum, exceed the total amount that would enable the DCO to meet its financial obligations to its members and participants notwithstanding a default by the member or participant creating the largest financial exposure for the DCO in extreme but plausible market conditions and to enable the DCO to cover its operating costs for one year.

- Participant and Product Eligibility: Each DCO must establish appropriate admission and continuing eligibility standards for members and participants and appropriate standards for determining the eligibility of contracts submitted for clearing. Each DCO must have procedures in place to verify its participation and membership requirements are met on an ongoing basis. Each DCO's requirements shall be objective, publicly disclosed, and permit fair and open access.

- Risk Management: Each DCO must have the ability to manage the risks associated with the responsibilities of a DCO through the use of appropriate tools and procedures. It must measure its credit exposures to its members at least once each business day and monitor them throughout the day. Each DCO must use margin requirements and other risk control mechanisms to limit its exposures to potential losses from member and participant default so that operations would not be disrupted. The margin required by a DCO from its members and participants must be sufficient to cover potential exposures in normal market conditions. Each DCO must use risk-based models and parameters which are reviewed regularly to set margin requirements.

- Settlement Procedures: Each DCO must complete money settlements on a timely basis (not less than once each business day); employ money settlement arrangements that limit the DCO's exposure to settlement bank risks; ensure money settlements are final when effected; maintain an accurate record of the flow of funds associated with each money settlement; be able to comply with the terms and conditions of any permitted netting or offset arrangements with other clearing organizations; clearly establish rules for physical settlement deliveries; and identify and manage the risks associated with physical settlements.

- Treatment of Funds: Each DCO must have standards and procedures to protect the safety of member and participant assets; must hold those assets in a manner whereby risk of loss or delay in access to the assets is minimized; and must hold those assets in instruments with minimal credit, market, and liquidity risks.

- Default Rules and Procedures: Each DCO must have publicly available rules and procedures designed to allow for efficient, fair, and safe management of member or participant insolvency or default. The default procedures must be clearly stated and ensure that the DCO takes timely action to contain losses.

- Enforcement: Each DCO must maintain adequate arrangements and resources for effectively monitoring and enforcing compliance with the DCO's rules and resolution of disputes. DCOs must have the authority to discipline, limit, or terminate members' and participants' activities for violations of its rules.

- System Safeguards: Each DCO must maintain a program of risk analysis and oversight; establish and maintain emergency procedures, backup facilities, and disaster recovery plans; and periodically test to ensure backup resources are sufficient.

- Reporting: Each DCO shall provide all information necessary to the CFTC for the CFTC to conduct oversight of the DCO.

- Recordkeeping: Each DCO shall maintain records for five years of all activities relating to its business.

- Public Information: Each DCO shall provide market participants with sufficient information to identify and evaluate risks and costs of using the DCO, as well as with the DCO's rules and operating procedures. Each DCO must publicly disclose information concerning the terms of conditions of transactions it clears and settles, fees the DCO charges its members and participants, the DCO's margin-setting methods, other information relevant to participating in settlement and clearing, and daily settlement prices, volume, and open interest for all contracts cleared or settled by the DCO.

- Information Sharing: Each DCO shall enter into and abide by all domestic and international information sharing agreements and use relevant information obtained from the agreements in carrying out its risk management.

- Antitrust Considerations: Each DCO must avoid adopting rules that result in an unreasonable restraint of trade or imposing any material anticompetitive burden.

- Governance Fitness Standards: Each DCO must establish transparent government arrangements and appropriate fitness standards for directors, disciplinary committee members, and members of the organization.

- Conflicts of Interest: Each DCO shall establish and enforce rules to minimize conflicts of interest and a process to resolve conflicts.

- Composition of the Boards: Each DCO must ensure that its governing board includes market participants.

- Legal Risk: Each DCO must have a well-founded, transparent, and enforceable legal framework for each of its activities.

Senate Bill §§ 713(b) (pp. 538-551) and 753(b); H.R. 4173 §§ 3103(b) and 3203(b).

The CFTC could conform the principles to evolving United States and international standards.

6. Reporting Requirements

Clearing agencies that clear security-based swaps would be required to provide the SEC and any security-based swap repository designated by the SEC all information determined by the SEC to be necessary to perform its responsibilities. The SEC would be required to adopt data collection and maintenance requirements for security-based swaps cleared by clearing agencies comparable to the corresponding requirements for security-based swaps accepted by security-based swap repositories and security-based swaps traded on ASEFs. The SEC must share that information with a variety of other regulators. Clearing agencies must provide the SEC with information to meet its public reporting requirements.

This section also establishes reporting requirements for DCOs. The section would require DCOs to provide the CFTC and any swap repository designated by the CFTC all information necessary to perform its responsibilities. The CFTC would be required to adopt recordkeeping requirements for DCOs that are comparable to the requirements for swaps accepted by swap repositories and traded on ASEFs. DCOs that clear security-based swaps would make information about those security-based swaps available to the SEC. The CFTC would share information with the Fed, SEC, appropriate Federal banking agencies, the Financial Stability Oversight Council, the Department of Justice, and foreign financial supervisors, central banks, and ministries. DCOs would also need to comply with public reporting requirements. **Senate Bill §§ 713(b) (pp. 551-552) and 753(b); H.R. 4173 §§ 3103(b) and 3203(b).**

7. Existing Banks and Clearing Agencies

Banks and clearing agencies that are required to register as DCOs under this Title, but which are already registered with the SEC under the ’34 Act would be deemed to be registered to the extent that they cleared swaps, as multilateral clearing organizations. They will also be subject to the provisions of this Title. If State law does not prohibit conversion, a bank to which this provision applies may convert, by a shareholder vote, into a State corporation, partnership, or limited liability company. **Senate Bill §§ 713(b) (pp. 553-554) and 753(b); H.R. 4173 §§ 3103(b) and 3203(b).**

E. Legal Certainty for Identified Banking Products

This section would repeal §§ 402(d), 404, 407, 408(b) and 408(c)(2) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. §§ 27(d), 27b, 27e, 27f(b), and 27f(c)(2)). It would amend the Act to insert Section 403 to indicate that the CEA does not apply to, and the CFTC does not exercise authority over identified banking products, nor shall the definitions of "security-based swap" and "security-based swap agreement" include any indentified banking product. The section provides that the appropriate Federal Banking Agency can require that an identified banking product be subject to the oversight above if the product would meet the definition of "swap" or "security-based swap" and has become known as a swap or security-based swap.

This section also states that the exclusions from regulation will not apply to an identified banking product that is a product of a bank not under the jurisdiction of a Federal banking agency; meets the definition of [security-based] swap, and has become known as a [security-based] swap. **Senate Bill §§ 713(c) (pp. 554-556)and 753(c); H.R. 4173 § 3103, § 3203.**

F. Public Reporting of Aggregate Swap Data

Section 714 would amend Section 8 of the Commodity Exchange Act (1 U.S. Code § 12) by adding a requirement that the CFTC make public aggregate swap data regarding trading volumes and positions, without disclosing business transactions or individual market positions. The CFTC may designate a DCO or swap repository to carry out the reporting. The CFTC would be required to gather data from required reports, DCOs, and swap repositories.

Likewise, Section 753(h) would amend Section 13 of the '34 Act (15 U.S. Code § 78m) by adding a requirement that the SEC make aggregate data regarding security-based trading volumes and positions publicly available in a manner that does not disclose individual positions or transactions. The SEC could designate a clearing agency or security-based swap repository to carry out the reporting requirement. The SEC could gather the information from clearing agencies, security-based swap repositories and reports received by the SEC. **Senate Bill §§ 714 (pp. 556-567) and 753(h); H.R. 4173 §§ 3104 and 3203.**

G. [Security-Based] Swap Repositories

This Senate Bill would amend the CEA (7 U.S. Code § 1 et seq.) by inserting after section 20 a section regarding swap repositories. Title VII would also amend Section 13 of the Securities Exchange Act of 1934 (15 U.S. Code § 78m) by adding a section regarding security-based swap repositories.

A person may register as a [security-based] swap repository by filing an application with the relevant Commission. Registered [security-based] swap repositories shall be subject to inspection and examination by the relevant Commission. Security-based swap repositories shall make information regarding security-based swaps available to the SEC and security-based swap repositories shall make information regarding swaps available to the CFTC upon request.

The relevant Commission shall prescribe standards that specify the data elements to be collected for each [security-based] swap, as well as the data collection and data maintenance

standards for [security-based] swap repositories. The SEC and CFTC's standards shall be comparable to each other.

[Security-based] swap repositories shall accept data prescribed by the relevant Commission for each [security-based] swap; maintain the data as required by the relevant Commission; provide the relevant Commission information required by the Commission; and make available on a confidential basis all the data gathered by the repository, including individual data to the CFTC, SEC, appropriate Federal banking agencies, the Financial Stability Oversight Council, DOJ, and other persons deemed appropriate by the SEC or CFTC, including foreign regulators.

All persons required to be registered as a swap repository must register with the CFTC, and all persons required to be registered as a security-based swap repository must register with the SEC, even if the person is also registered with the other Commission, though the relevant Commission may exempt a person from registration if it finds that the person already is subject to comparable comprehensive supervision and regulation by the SEC, CFTC, or appropriate governmental authorities in the organization's home country. The SEC and CFTC must adopt uniform rules governing [security-based] swap repositories within 180 days after the effective of the Title. **Senate Bill §§ 715 (pp. 557-561) and 753(h); H.R. 4173 §§3105, 3203(j).**

H. Reporting and Recordkeeping

Senate Bill §§ 716 and 755 would require any person who enters into a [security-based] swap to satisfy reporting requirements if that person did not clear the [security-based] swap or did not have data about the [security-based] swap accepted by a swap repository in accordance with the rules. The person must make reports required by the SEC or CFTC and must keep books and records pertaining to the [security-based] swaps as required by the relevant Commission. The information must be identical to or more comprehensive than the information collected by [security-based] swap repositories. **Senate Bill §§ 716 (pp. 561-562) and 755; H.R, 4173 §§ 3104, 3106, 3203, and 3205.**

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

1. Registration Requirements

The Title would amend the Commodity Exchange Act (7 U.S.C. § 1 et seq.) by adding Section 4s and the '34 Act by adding Section 15F, governing the registration and regulation of [security-based] swap dealers and MSPs. Under these sections, [security-based] swap dealers and MSPs must register with the relevant Commission with an application prescribed by the Commission and must continue to provide the Commission with information on an ongoing basis. These sections give the CFTC and SEC authority to prescribe rules applicable to [security-based] swap dealers and MSPs that limit their activities. The SEC and CFTC must require [security-based] swap dealers and MSPs to register not later than one year after the effective date of the Title.

The Title would make it unlawful for a [security-based] swap dealer or MSP to permit a person associated with the dealer or MSP who is subject to a statutory disqualification to effect

or be involved in effecting [security-based] swaps if the dealer or MSP knows or should know of the disqualification.

If a person is required to be registered with the SEC under these provisions, then he must register, regardless of whether that person is also a bank or registered with the CFTC; similarly, if a person is required to be registered with the CFTC, then he must register, regardless of whether that person is a bank or registered with the SEC. No later than 180 days after the Title's effective date, the SEC and CFTC must jointly adopt uniform rules for persons registered as swap dealers or major swap participants and security-based swap dealers or major security-based swap participants. The SEC and CFTC shall not, however, prescribe rules imposing prudential requirements (including activity restrictions) on [security-based] swap dealers and MSPs for which there are a primary financial regulatory agency. The SEC and CFTC can, though, prescribe appropriate business conduct, reporting, and recordkeeping requirements for investor protection. **Senate Bill §§ 717 (pp. 562-566) and 753(d); H.R. 4173 §§ 3107 and 3204.**

2. Capital and Margin Requirements

Each [security-based] swap dealer and MSP for which there is a primary financial regulatory agency must meet minimum capital and minimum initial and variation margin requirements set by the primary financial regulatory agency For bank [security-based] swap dealers and MSPs, the SEC, CFTC, and primary financial regulatory agency shall adopt rules jointly imposing capital and margin requirements. For non-bank [security-based] swap dealers and MSPs, the SEC and CFTC shall jointly adopt rules imposing capital and margin requirements. These rules must be adopted within 180 days of enactment **Senate Bill § 717 (pp. 566-568).**

Section 723 would strike provisions from Section 8a of the CEA (7 U.S.C. § 12a) so that the CFTC would not be prevented from setting margin levels. **Senate Bill § 723 (p. 609).**

a) Capital Requirements for Bank Swap Dealers and Major Swap Participants

The capital requirements for bank [security-based] swap dealers and MSPs would be required to contain a capital requirement greater than zero for swaps cleared by a DCO and security-based swaps cleared by a clearing agency. For non-cleared [security-based] swaps, the capital requirement must be "substantially higher" to offset the greater risk to the dealer, MSP, and financial system. **Senate Bill § 717 (pp. 568-569).**

b) Capital Requirements for Nonbank Swap Dealers and Major Swap Participants

The capital requirements for nonbank [security-based] swap dealers and MSPs would need to be as strict or stricter than the capital requirements prescribed for bank [security-based] swap dealers and MSPs. **Senate Bill § 717 (pp. 569-570).**

c) Rule of Construction

The Title makes clear that these sections do not limit the CFTC's ability to set financial responsibility rules for futures commission merchants or introducing brokers, or the SEC's ability to set financial responsibility rules for brokers or dealers. Futures commission merchants, introducing brokers, brokers, and dealers would be required maintain sufficient capital to comply with the strictest capital requirements to which the dealer is subject to under this Title or the '34 Act. **Senate Bill §§ 717 (pp. 570-571) and 753(d); H.R. 4173 §§ 3107 and 3204.**

d) Margin Requirements

For all [security-based] swaps not cleared by a DCO, the primary financial regulatory agency would set initial and variation margin requirements for bank [security-based] swap dealers and MSPs. The primary financial regulatory could conditionally or unconditionally exempt a [security-based] swap dealer or MSP from margin requirements with regard to any swap in which one of the counterparties is (1) not a [security-based] swap dealer or MSP; (2) using the [security-based] swap as part of an effective hedge under generally accepted accounting principles; and (3) predominantly engaged in non-financial activities. The primary financial regulatory would need to provide written notice to the FSOC describing the proposed exemption. The exemption would only be effective if the FSOC does not notify the primary financial regulatory agency within 60 days that the exemption would pose a threat to the stability of the United States financial system.

In prescribing margin requirements, the regulators could permit the use of noncash collateral as they determine to be consistent with preserving the financial integrity of markets trading swaps and preserving the stability of the United States financial system.

If any party to a [security-based] swap that is exempt from margin requirements requests that the swap be margined, the exemption shall not apply and the counterparty shall provide the margin. **Senate Bill §§ 717 (pp. 571-577) and 753(d); H.R. 4173 §§ 3107 and 3204.**

3. Reporting and Recordkeeping

Each [security-based] swap dealer and MSP would be required to make reports to the SEC and CFTC as prescribed by rule or regulation. Those records would be open to inspection by any representative of the relevant Commission. The SEC and CFTC must jointly adopt rules within one year of the enactment date governing reporting and record keeping requirements for [security-based] swap dealers and MSPs.

Each registered [security-based] swap dealer and MSP would have to maintain daily trading records of its swaps and all related records, and all recorded communications, including e-mail, instant messages, and telephone call recordings. Each registered [security-based] swap dealer and MSP shall maintain daily trading records for each customer or counterparty so that each record is identifiable with each transaction.

Each registered [security-based] swap dealer and MSP would also be required to maintain a complete audit trail for conducting comprehensive and accurate trade reconstructions, though a

registered [security-based] swap repository may perform that function on behalf of the [security-based] swap dealer or MSP.

Within a year of enactment, the SEC and CFTC would jointly adopt rules governing daily trading records for [security-based] swap participants and MSPs. **Senate Bill §§ 717 (pp. 577-579) and 753(d); H.R. 4173 §§ 3107 and 3204.**

4. Business Conduct Standards

Each registered [security-based] swap dealer and MSP would be required to conform with business conduct standards prescribed by rules and regulations, including standards addressing fraud, manipulation, and other abusive swap practices; diligent supervision of its business as a [security-based] swap dealer; adherence to applicable position limits; and other matters that the relevant Commission determines to be appropriate.

Business conduct standards adopted by the SEC and CFTC would establish a standard of care for a [security-based] swap dealer or MSP to verify that counterparties meet the eligibility requirements for eligible contract participants and require disclosure by [security-based] swap dealers or MSPs to counterparties (except to other [security-based] swap dealers or MSPs) of information about material risks and characteristics of the swap; the source and amount of fees or other material remuneration the dealer or MSP would expect to receive; and any other material incentives or conflicts of interest the dealer or MSP may have in connection with the [security-based] swap.

The conduct standards would also establish a standard of conduct for a dealer or MSP to communicate in a fair and balanced manner based on principles of fair dealing and good faith and establish a standard of conduct for dealers and MSPs with respect to counterparties who are eligible contract participants so that the dealer or MSP can have a reasonable basis to believe the counterparty has an independent representative that has sufficient knowledge to evaluate the transaction and risks, is not statutorily disqualified, is independent of the dealer or MSP, and that undertakes a duty to act in the counterparty's best interests, makes appropriate disclosures, and will provide written representation to the eligible contract participant regarding fair pricing and the appropriateness of the transaction. Within one year of the Title's enactment, the SEC and CFTC would be required to jointly prescribe rules governing business conduct standards for [security-based] swap dealers and MSPs. **Senate Bill §§ 717 (pp. 579-583) and 753(d); H.R. 4173 §§ 3107 and 3204.**

5. Documentation and Back Office Standards

Each registered [security-based] swap dealer and MSP would be required to conform with standards addressing timely and accurate confirmation, processing, netting, documentation, and valuation of all swaps. Within one year of the Title's enactment, the SEC and CFTC would be required to jointly adopt rules governing documentation and back office standards for [security-based] swap dealers and MSPs.

Each registered [security-based] swap dealer and MSP would need to monitor its trading in swaps to prevent violations of position limits and must disclose to the relevant Commission information regarding terms and conditions of swaps, swap trading operations, mechanisms, and

practices, financial integrity protections, and other information relevant to its trading in [security-based] swaps. The dealer or MSP would establish and enforce internal procedures to obtain necessary information to carry out these functions and provide the information to the relevant Commission upon request.

The [security-based] swap dealer and MSP would be required to implement conflict of interest systems and procedures that establish structural and institutional safeguards within the firm to ensure that the activities of any person relating to research or analysis of the price or market for any commodity are separated from the review, pressure, or oversight of those who may be biased by their involvement in trading or clearing activities.

The SEC and CFTC would be required to consult with each other prior to adopting any rules under the Title. The CFTC and SEC shall jointly adopt rules mitigating conflicts of interest in connection with [security-based] swap dealers or MSPs' conduct of business with DCOs, clearing agencies, boards of trade, or ASEFs that clear or trade swaps in which the dealer or MSP has a material debt or equity investment. **Senate Bill §§ 717 (pp. 583-586) and 753(d); H.R. 4173 §§ 3107 and 3204.**

J. Segregation of Assets Held as Collateral in [Security-Based] Swap Transactions

Section 718 would amend the CEA (7 U.S.C. § 1 et seq.) by inserting Section 4t dealing with the segregation of assets held as collateral in swap transactions. Section 754 would amend the '34 Act (15 U.S.C. § 78a et seq.) by adding Section 3D regarding the segregation of assets held as collateral in security-based swap transactions.

These sections would require that a [security-based] swap dealer, futures commission merchant, DCO, or clearing agency that holds initial margin or collateral segregate, maintain, and use the funds or other property for the benefit of the counterparty according to rules prescribed by the relevant Commission or primary regulatory agency (for bank [security-based] swap dealers). The funds or other property shall be treated as customer property.

If a [security-based] swap is not submitted for clearing and a [security-based] swap counterparty who provides the funds or other property as initial margin or collateral to a dealer requests that the dealer segregate the funds or other property, then the dealer would be required to segregate the funds and maintain them in an account carried by an independent third-party custodian, according to rules prescribed the relevant Commission for non-bank [security-based] swap dealers, futures commission merchants, DCOs, or clearing agencies, or the primary financial regulator for bank[security-based] swap dealers. The segregation should be made available on a fair, non-discriminatory basis. **Senate Bill §§ 718 (pp. 586-588) and 754; H.R. 4173 §§ 3122 and 3203.**

K. Conflicts of Interest

Section 719 would amend Section 4d of the CEA (7 U.S.C. § 6d) by adding a conflicts of interest provision as subsection (c).

The CFTC would require that futures commission merchants and introducing brokers implement conflict of interest systems that establish structural and institutional safeguards to assure that the activities of any person in the firm relating to research or analysis of the price or market for any commodity are separated by informational partitions from the review, pressure, or oversight of those who may be biased by their involvement in trading or clearing. **Senate Bill § 719 (pp. 588-589).**

L. Alternative Swap Execution Facilities

1. Registration

Section 720 would add Section 5h after section 5g to the Commodity Exchange Act (7 U.S.C. § 1 et seq.) regarding alternative swap execution facilities (ASEFs). Section 753(b) adds Section 3C after section 3B in the '34 Act (15 U.S.C. § 78a et seq.). These sections define an "alternative swap execution facility" as an "electronic trading system with pre-trade and post-trade transparency in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by other participants that are open to multiple participants in the system, but which is not [an exchange or designated contract market]." ASEFs would need to be registered under Section 720 or as a designated contract market with the CFTC, even if they are already registered with the SEC. Similarly, ASEFs required to register with the SEC would register with the SEC, even if that person is already registered with the CFTC as an ASEF. ASEFs registered with the CFTC could trade any swap; ASEFs registered with the SEC could trade any security-based swap. **Senate Bill §§ 720 (pp. 589-590) and 753(b) (pp. 665-675).**

2. Trading by Contract Markets

A board of trade that operates a contract market and an ASEF that use the same electronic trade execution system would be required identify whether electronic trading is taking place on the contract market or the ASEF. To qualify for registration as an ASEF, the facility would need to meet certain criteria, including: the establishment and enforcement of rules that will deter abuses and the capacity to detect, investigate, and enforce those rules; the establishment and enforcement of rules defining trading procedures to be used in entering and executing orders traded on or through its facilities; and the establishment and enforcement of rules for ensuring the financial integrity of swaps entered on or through its facilities, including the clearance and settlement of swaps.

Similarly, if an exchange operates an ASEF and uses the same electronic trade execution system for both, then the exchange would need to identify whether trading is taking place on the exchange or ASEF. The facility would be required to demonstrate the same criteria as above to qualify for registration. **Senate Bill §§ 720 (pp. 590-592) and 753(b) (pp. 665-675).**

3. Core Principles for Alternative Swap Execution Facilities

To maintain its registration, an ASEF would be required comply with core principles, using its own discretion (except where the relevant Commission determines otherwise), including:

- Compliance with Rules: Each ASEF must monitor and enforce compliance with the facility's rules.

- [Security-Based] Swaps Not Readily Susceptible to Manipulation: Each ASEF shall permit trading only in [security-based] swaps that are not readily susceptible to manipulation.

- Monitoring of Trading: Each ASEF shall monitor trading in [security-based] swaps to prevent manipulation, price distortion, and disruptions of delivery or cash settlement through surveillance, compliance, and disciplinary procedures, including real-time monitoring of trading and comprehensive trade reconstructions.

- Ability to Obtain Information: Each ASEF shall establish and enforce rules that allow the facility to obtain necessary information to perform its functions, provide the information to the CFTC or SEC upon request, and have the capacity to carry out international information-sharing agreements.

- Position Limits or Accountability: To reduce the threat of market manipulation or congestion and to eliminate excessive speculation, an ASEF shall adopt where necessary and appropriate, position limitations or position accountability for speculators. For any contract subject to a position limit established by the CFTC or SEC, the ASEF shall set its position limit at a level no higher than the Commission limit.

- Emergency Authority: Each ASEF shall adopt rules to provide for the exercise of emergency authority, including the authority to liquidate or transfer open positions in any [security-based] swap or to suspend or curtail trading in a [security-based] swap.

- Timely Publication of Trading Information: Each ASEF shall publicize timely information on price, trading volume, and other trading data on [security-based] swaps.

- Recordkeeping and Reporting: Each ASEF shall maintain business records, including a complete audit trail, for five years; report to the relevant Commission all information determined by the Commission to be necessary to perform its responsibilities; and to make available to the SEC or CFTC, upon request, all information relating to transactions in security-based swap or swap agreements. The CFTC shall adopt data collection and reporting requirements for ASEFs that are comparable to requirements for DCOs and swap repositories and the SEC shall adopt data collection and reporting requirements for ASEFS that are comparable to requirements for clearing agencies and security-based swap repositories.

- Antitrust Considerations: Unless necessary or appropriate to achieve the Title's purposes, an ASEF shall avoid adopting any rules or taking any actions that result

in an unreasonable restraint of trade; or imposing any material anticompetitive burden on trading on the swap execution facility.

- Conflicts of Interest: Each ASEF shall establish and enforce rules to minimize conflicts of interest in its decision-making process and establish a process for resolving conflicts.

- Designation of a Compliance Officer: Each ASEF must designate a compliance officer who will report to the board, review the ASEF's compliance with core principles, consult with the board to resolve conflicts of interest, administer the ASEF's policies and procedures, ensure compliance with commodity laws, and establish procedures for remediation of noncompliance issues. The compliance officer also must prepare and sign annual reports on the ASEF's compliance with commodity laws and its facilities and procedures, which must be submitted with the ASEF's financial reports to the CFTC or SEC. **Senate Bill §§ 720 (pp. 590-599) and 753(b) (pp. 665-675).**

4. Exemptions

The CFTC or SEC could exempt, conditionally or unconditionally, an ASEF from registration if the CFTC finds the facility is subject to comparable, comprehensive supervision and regulation on a consolidated basis by the SEC or CFTC, the primary financial regulatory agency, or foreign governmental authorities. Within 180 days of the enactment date, the CFTC and SEC would be required to jointly prescribe rules governing ASEF regulation. **Senate Bill §§ 720 (p. 599) and 753(b).**

M. Derivatives Trading Execution Facilities and Exempt Boards of Trade

Section 721 would repeal CEA Sections 5a and 5d (7 U.S.C. § 7a and 7a-3) which currently govern derivatives transaction execution facilities and would make conforming amendments accordingly. **Senate Bill § 121 (pp. 600-606); H.R. 4173 §§ 3109 and 3203(d).**

N. Designated Contract Markets

Section 722 would amend CEA Section 5(d) (7 U.S.C. § 7(d)(9)), governing core principles for contract markets. The new paragraph would provide that boards of trade must provide competitive, open, and efficient markets and mechanisms for executing transactions that protect the price discovery process of trading. The rules may authorize, for bona fide business purposes, the transfer of trades or office trades, exchanges of futures, or futures commission merchants to enter into or confirm the execution of a contract for the purchase or sale of commodities for future delivery if the contract is reported, recorded, or cleared.

Section 722 also would add paragraphs (19) and (20) to the end of CEA Section 5(d). Paragraph (19) would provide that boards of trade must have adequate financial, operational, and managerial resources to discharge the responsibilities of a contract market. To be considered adequate, the resources' value must exceed the total amount that would enable the market to cover its operating costs for one year.

Paragraph (20) would require that boards of trade establish risk analysis and oversight programs, emergency procedures, backup facilities, and disaster recovery plans. They also would have to periodically conduct tests to ensure that back-up resources are sufficient. **Senate Bill § 722 (pp. 606-609).**

O. Position Limits

Section 724 would amend Section 4a(a) of the CEA (7 U.S.C. § 6a(a)) to require the CFTC to regulate excessive speculation in swaps that perform a significant price discovery function on regulated markets. Similarly, Section 753(g) would amend the '34 Act by adding Section 10B after Section 10A (15 U.S.C. § 78j-1).

The CFTC would be authorized to establish limits on the aggregate number or amount of positions in contracts based upon the same underlying commodity that may be held by any person, including any group or class of traders, for each month. The restrictions can be across contracts listed by designated contract markets, contracts traded on a foreign board of trade that provide United States members with direct access to its electronic trading and order matching system, and swap contracts that perform a significant price discovery function.

When determining whether a swap performs a significant price discovery function, the CFTC would be required to consider: (A) the extent to which the swap relies on a price parameter of another contract to value, transfer, convert, settle, or close out a position; (B) the extent to which the swap's price is related to the price of another contract, so as to permit market participants to effectively arbitrage between markets by simultaneously maintaining positions or executing trades in the swaps on a frequent basis; (C) the extent to which, on a frequent and recurring basis, transactions in a contract on a regulated market are based on the swap's price; (D) the extent to which the volume of the swaps traded in the commodity can have a material effect on another contract traded on a regulated market; and (E) other material factors determined by the CFTC. The CFTC could exempt any person or class of persons, or any swap or class of swaps, from any position limit requirement.

The SEC would be authorized to establish limits on the aggregate number or amount of positions that may be held by any person or persons across security-based swaps that perform or affect a significant price discovery function. The SEC may exempt any person or class of person, or any security-based swaps or class of security-based swaps, from any position limit requirement. The SEC also would be authorized to direct a self-regulatory organization to adopt position limits in any security-based swap and any security on which a security-based swap is based that may be held by that SRO or any person for whom a member of the SRO effects transactions in that security-based swap or security. **Senate Bill §§ 724 (pp. 609-613) and 753(g) (pp. 709-711).**

P. Enhanced Authority Over Registered Entities

Section 725 would amend CEA Section 5(d)(1) (7 U.S.C. § 7(d)(1)) and CEA Section 5b(c)(2)(A) (7 U.S.C. § 7a-1(c)(2)(A)) to provide that in establishing core principles, boards of trade and applicants to become derivatives clearing organizations shall have discretion, except

where the CFTC determines otherwise. It also would amend Section 5c(a) of the CEA (7 U.S.C. § 7a-2(a)) to provide that a CFTC interpretation of core principles may be controlling.

Section 725 provides that unless section 805(e) of the Payment, Clearing, and Settlement Supervision Act of 2009 applies, a new derivatives contract or instrument, or the clearing of a contract or instrument, would become effective 10 business days after the CFTC's receipt of the certification unless the CFTC notifies the registered entity that it is staying the certification because a novel issue exists that it needs time to analyze. **Senate Bill § 725 (pp. 613-615).**

Q. Foreign Boards of Trade

Section 726 would make technical amendments to the CEA. It also would amend CEA Section 4(b) (7 U.S.C. § 6(b)) to provide that the CFTC may adopt rules and regulations requiring foreign boards of trade to register with the CFTC if the boards provide members or participants located in the United States direct access to their electronic trading and order matching systems. "Direct access" means an explicit grant of authority by the foreign board to an identified member or participant located in the United States to enter trades directly into the electronic trading and order matching system.

It would be unlawful for a foreign board of trade to provide its United States members and participants access to its electronic trading and order matching systems with respect to a transaction that settles against any price of one or more contracts listed for trading on a registered entity, unless the CFTC determines that: (A) the board makes public daily trading information regarding the transaction that is comparable to the daily information published by the registered entity; and (B) the board adopts position limits for the transaction comparable to the position limits adopted by the registered entity for which one or more contracts against which the transaction traded on the foreign board settles; has authority to require market participants to limit, reduce, or liquidate any position the foreign board determines to be necessary to reduce the threat of price manipulation or excessive speculation. The foreign board must agree to notify the CFTC with regard to the transaction that settles against any price of one or more contracts listed for trading on a registered entity of any change regarding the information the board will make publicly available, the board's position limits, the position reductions required to prevent manipulation and excessive speculation, and any other area of interest expressed by the CFTC to the board. The board must provide information to the CFTC regarding large trader positions in the transaction that is comparable to the large trader position information collected by the CFTC for the one or more contracts against which the transaction traded on the foreign board settles. Finally, the foreign board must provide the CFTC with information necessary to publish reports on aggregate trader positions for the transaction traded on the foreign board that are comparable to the reports on aggregate trader positions for the one or more contracts against which the transaction traded on the foreign board settles.

Foreign boards of trade to which the CFTC has granted direct access permission before the subsection's enactment date would be grandfathered and would not have to comply with the preceding requirements.

The section specifically notes that a person registered with the CFTC or exempt from registration under the Act may not be found to have violated these provisions if the person has

reason to believe that a transaction in a contract of sale of a commodity for future delivery is made on or subject to the rules of a foreign board of trade that has complied with the above requirements.

The section also provides that the failure of a foreign board of trade to comply with any provision of the Act does not invalidate a contract of sale of a commodity for future delivery traded or executed on or through the facilities of a foreign board. **Senate Bill § 726 (pp. 615-621).**

R. Legal Certainty for Swaps

Section 727would CEA Section 22(a)(4) (7 U.S.C. 25(a)(4)) to provide that no hybrid instrument sold to an investor shall be void based solely on its failure to comply with CEA Section 2(f), which provides an exclusion for hybrid instruments from regulation. Section 727 also provides that no transaction between eligible contract participants or persons reasonably believed to be eligible contract participants shall be void based solely on its failure to meet the definition of a "swap" or to be cleared. **Senate Bill § 727 (pp. 621-622).**

S. FDICIA Amendments

Section 728 would repeal sections 408 and 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4421-4422) which provide definitions pertaining to derivatives and govern multilateral clearing organizations. **Senate Bill § 728 (p. 622).**

T. Enforcement

1. CFTC

Section 729 would amend the CEA (7 U.S.C. § 1 et seq.) by adding Section 4b-1 regarding primary enforcement authority. Section 729 would give the CFTC primary authority to enforce the provisions of the Act's subtitle A with respect to any person, though the primary financial regulatory agency would have exclusive authority to enforce section 4s(e) and other prudential requirements with respect to banks or branches or agencies of foreign banks that are swap dealers or MSPs. If the primary financial regulatory agency believes that a swap dealer or MSP has violated the nonprudential requirements of the section, though, then the agency may recommend an enforcement proceeding to the CFTC in writing. If the CFTC does not initiate an enforcement proceeding within 90 days, then the primary financial regulatory agency may initiate a proceeding. **Senate Bill §729 (pp. 622-624).**

2. Primary Financial Regulatory Agency

Similarly, Section 753(d) would amend the '34 Act to provide that the primary financial regulatory agency for bank security-based swap dealers and MSPs will have exclusive authority to enforce prudential requirements of the Title with respect to banks and branches or agencies of foreign banks that are security-based swap dealers or MSPs. If the primary financial regulator believes that the security-based swap dealer or MSP has violated the Title's nonprudential requirements, then the agency may refer the action to the SEC. If the SEC does not take action

within 90 days, then the primary financial regulator may initiate an enforcement proceeding. **Senate Bill § 753(d) (pp. 701-703).**

3. SEC Enforcement

Section 753(d) would amend the '34 Act to give the SEC authority to carry out enforcement actions against security-based swap dealers and MSPs and people who are associated with or are seeking to become associated with swap dealers or MSPs. Once the SEC has entered an order against one of these people, it will be unlawful for that person to become or become associated with a security-based swap dealer or MSP without the SEC's consent. **Senate Bill § 753(d) (pp. 703-704).**

Section 730 would make numerous conforming amendments to various parts of the CEA primarily to allow enforcement actions to take place with regard to misconduct in the use of swaps. **Senate Bill § 730 (pp. 624-626).**

U. Retail Commodity Transactions

Section 731 would amend Section 2(c) of the CEA (7 U.S.C. § 2(c)) by making conforming amendments and by giving the CFTC jurisdiction over retail commodity transactions. **Senate Bill § 731 (pp. 626-629).**

V. Large [Security-Based] Swap Trader Reporting

Section 732 would add Section 4t to the CEA (7 U.S.C. § 1 et seq.) which would govern large swap trader reporting. Section 753(g) would add Section 10B(d) to the '34 Act. The section would require that any person who enters into any [security-based] swap must file with the CFTC or SEC several reports.

Traders in swaps must provide to the CFTC reports including records regarding transactions and positions in commodities traded on or subject to the rules of any board or trade and on cash or spot transactions in, inventories of, and purchase and sale of, any related commodity traded on or subject to the rules of any board of trade if the person directly or indirectly enters into the swaps during anyone one day in an amount equal to or exceeding an amount fixed by the CFTC and the person directly or indirectly has a position in the swaps equal to or exceeding an amount fixed by the CFTC. The reports of positions and transactions must include positions and transactions of persons directly or indirectly controlled by the reporting person.

Traders in security-based swaps must keep books and records of any security-based swaps or transactions in positions in any related security traded on or subject to the rules of any national securities exchange. The also must keep books and records of any cash or spot transactions in, inventories of, and purchase and sale commitments of any related security traded on or subject to the rules of any national securities exchange if the person directly or indirectly equals or exceeds the SEC-set limit on that security-based swap in one day and that person directly or indirectly obtains a position in the security-based swaps equal to or exceeding an amount set by the SEC. The books and records shall show complete details concerning all

positions and transactions as directed by the SEC and be open to inspection at all times by the SEC.

The required books and records must show complete details regarding all transactions and positions as required by the CFTC and be open at all times to inspection by the CFTC and to the SEC, to the extent that the records pertain to security-based swap agreements. **Senate Bill §§ 732 (pp. 629-632) and 753(g) (pp. 709-711).**

W. Other Provisions and Amendments

1. Savings Provision

This section clarifies that this subtitle would not divest any appropriate Federal banking Agency, the CFTC, the SEC, or any other Federal or State agency of any authority derived from any other applicable law, unless the subtitle provides so by its terms. **Senate Bill §§ 733 (p. 632) and 758 (p. 727).**

Further, nothing in the amendments made by this subtitle would be construed to modify or impair the operation of any antitrust laws. **Senate Bill § 734 (p. 632).**

2. State Gaming and Bucket Shop Laws

Section 756 would amend Section 28(a) of the '34 Act (15 U.S.C. § 78bb(a)) to provide that the rights and remedies provided by this Title shall be in addition to all other rights and remedies that exist in law or equity, but a person may not recover damages in excess of actual damages. The section clarifies that nothing in the Title shall affect the jurisdiction of any State's securities commission over any security or any person insofar as it does not conflict with the provisions of the Title or rules or regulations thereunder. The section specifies that no state law shall invalidate securities subject to the Title, security-based swaps between eligible contract participants, or security-based swaps effected on a national securities exchange. **Senate Bill § 756 (pp. 723-725).**

3. Amendments to the Securities Act of 1933; Treatment of Security-Based Swaps

Section 757 would amend Section 2(a) of the '33 Act (15 U.S.C. § 77b(a)) to include security-based swaps in the definition of a "security" and makes other conforming amendments to the '33 Act. **Senate Bill § 757 (pp. 725-726).**

4. International Harmonization

Section 761 would direct the SEC, CFTC, the FSOC, and the Treasury Department to consult and coordinate with foreign regulatory authorities regarding the establishment of consistent international standards for the regulation of swaps and authorizes those regulators to enter into information-sharing arrangements with foreign regulators. **Senate Bill § 761 (p. 728).**

5. Interagency Cooperation

The SEC and CFTC would be required to establish a joint advisory committee to develop solutions to issues of ongoing interest relating to the trading and regulation of products regulated by the SEC and CFTC, including securities, commodity futures, swaps, and security-based swaps. The committee shall be fairly balanced, include at least one representative from each of the SEC and CFTC, and include other individuals with relevant expertise. The committee must report its findings and recommendations every six months to the Senate Banking Committee, the House Financial Services Committee, and the House and Senate Agriculture Committees.

The SEC and CFTC would be required to jointly establish an interagency Joint Enforcement Task Force to improve market oversight, enhance enforcement, and relieve duplicative regulatory burdens. Staff from each agency will participate on the task force. The task force will offer training programs for staffs of both agencies. The SEC, CFTC, and the Fed would also jointly establish a Trading and Markets Fellowship Program to enhance staff understanding about the interactions between financial markets and the economy. Each agency would announce three employees to participate in the fellowship program each year. Finally, the SEC and CFTC would jointly establish a cross-agency training and education curriculum for enforcement personnel. **Senate Bill § 762 (pp. 728-733).**

6. Study and Report on Implementation

The GAO would be required to conduct a study of how the CFTC and SEC have implemented this Title, the extent to which jurisdictional disputes have created challenges in implementing the Title, and the benefits and drawbacks of harmonizing the laws implemented by the CFTC and SEC, and merging those agencies. **Senate Bill § 763 (pp. 733-735).**

7. Recommendations for Changes to Insolvency Laws

Within 180 days of enactment, the SEC and CFTC would be required to transmit to Congress recommendations on legislative changes to Federal insolvency laws to enhance legal certainty with respect to swap participants clearing swaps and security-based swaps and to clarify and harmonize the insolvency law framework applicable to commodity brokers and registered brokers or dealers, and to facilitate the portfolio margining of securities and commodities futures and options positions. **Senate Bill § 764 (pp. 735-736).**

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 and 802(a)(1) (pp. 736-737).**

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. 737).** 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. 734); See, also, Senate Bill § 805(b) (p. 751).

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. 738).** 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. 738).** Moreover, the proposal is designed to strengthen the liquidity of utilities. **Senate Bill § 802(b)(3) (p. 738).**

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) (pp. 738 - 739) and Senate Bill § 804(a)(1) (p. 745)**.[11] In addition, "financial institution" would broadly include all depository institutions,

---

[11] 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) (p. 729).**

foreign bank 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(2) (p. 739).**

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(4) (pp. 739-740)** 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) (pp. 741-742).** The Council would also have authority to add any similar transactions it determines are "financial transactions". **Senate Bill §§ 804(6)(B)(xii) (p. 742).**

"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(7) (pp. 743-744).** 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. 745-746).

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. 29).**

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. 747).** 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. 747-748).** 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. 748-749).**

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) (pp. 750-751).** 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. 751).** 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. 751-752).

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) (pp. 752-753).** The Fed can authorize the Federal Reserve Bank to provide the utility discount and borrowing privileges**. Senate Bill § 806(b) (p. 753).** 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) (p. 753).**

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) (p. 754).** 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. 755).** 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) (pp. 755-756).** 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. 756-757).**

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. 757-758).** 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. 758).** The supervisory agency or the Fed could require modification or rescission of the policy. **Senate Bill § 806(e)(2)(D) (pp. 758-759).**

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. 759-760).**

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. 743-744).** 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. 760).** 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. 761).** 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. 761-763).** 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. 763-764).**

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. 765).** 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. 766-767).** 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. 767-768).** 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. –768-772).**

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) (p. 773).** 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. 773).**

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. 774).** 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) (pp. 774-775).** 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. 775-776).** 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) (pp. 776-777).**

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 (p. 778).**

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 (pp. 778).**

K. Effective Date

The proposal would be effective as of the date the Act is enacted. **Senate Bill § 812 (p. 779).**

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

A. Increasing Investor Protection

1. Investor Advisory Committee

The Senate Bill would also 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. 779-784)**; **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. 794-800).**

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. 784-785).** 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" **Senate Bill § 913(b) (pp. 785-786).**

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.,* individual customers of a broker-dealer, investment adviser, or their associated persons. **Senate Bill § 913(a) (p. 785).** 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. 786-791).

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. 792-794).** 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. 808-810); 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. 812-814).**

d) 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. 814-815).**

e) 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. 816-819).**

6. 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. 811-812).**

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. 794-795).**

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. 882-823).** 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 (pp. 823-825); 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 (pp. 826-827); 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 (p. 825); 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 (pp. 827-830); 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 (p. 830-837); H.R. 4173 § 7203(a) (pp. 1301-1304).**

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 (833-836); 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. 837-838); 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. 838-839); 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. 839-841); H.R. 4173 § 7206 (pp. 1309-1311).**

4. Authority of State Regulators Over Regulation D Offerings

Section 926 of the Senate Bill would amend Section 18(b)(4) of the Securities Act of 1933 to exclude from the exemption from state regulation of securities offerings those securities that the SEC designates as "non-covered securities" because the offering is not of sufficient size or scope. Within 360 days of enactment of the Act, the SEC would be required to conduct rulemaking to determine whether to so designate a class of securities. In designating "non-covered securities," the SEC would be directed to consider the size of the offering, the number of states in which the security is being offered; and the nature of the persons to whom the security is being offered. No later than 180 days after enactment of the Restoring American Financial Stability Act of 2010, the SEC is mandated to implement procedures, following consultation with the states, to notify states promptly upon the SEC's completion of its review of Regulation D offerings.

Pursuant to new paragraph (b)(4)(C) of Section 18, the SEC would be required to review filings (*i.e.*, Form Ds) of covered securities sold pursuant to section 4(2) of the Securities Act of 1933 within 120 days of the filing with the SEC. If the SEC fails to review a filing within 120 days, the security would no longer be a "covered security" for purposes of the federal pre-emption provided by Section 18 unless the SEC determines that there was a good faith and reasonable attempt by the issuer to comply with all filing requirements, terms and conditions, and after reviewing the filing, the SECdetermines that any failure to comply with the fling requirements was insignificant to the offering as a whole. The Senate Bill states that the new provisions do not prohibit states from adopting notice filing requirements. **Senate Bill § 926 (pp. 841-844).** H.R. 4173 does not seek to eliminate federal pre-emption with respect to Regulation D offerings.

5. 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. 782-790).** 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

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. 847-850).**

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. 850); 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. 850-851).** 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. It would 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. 871-873).** 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. 873-874).** 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. 851-852).** 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. 861).**

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(2) (p. 852); 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. 853-854).**

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. 854-856).**

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. 857-860).** 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. 861-862); 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. 862).**

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. 862-864); 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. 864-869).**

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. 869-871); 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. 871-872).** 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. 843-844); 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. 874-876).**

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. 876-877).** 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. 877).** 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 Bill § 936 (pp. 877-878).** 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. 878); 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. 878-879); 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. 878); H.R. 4173 § 6002 (pp. 1243-1244).**

8. Various Studies

a) Statutory References to Credit Ratings

The Senate Bill would require that the Comptroller conduct a study, which would be submitted to the Senate Banking Committee and the House Financial Services Committee, of federal and state laws that require the use of ratings issued by NRSROs, recommend to Congress which of the laws studied could be amended to remove ratings requirements with minimal disruption to the markets and evaluate whether the financial markets and investors would benefit from the elimination of ratings requirements. Additionally, the SEC, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Fed, the National Credit Union Administration, and the Federal Housing Finance Agency would be required to review their regulations and remove any reference to credit ratings or a credit ratings requirement, and to substitute an appropriate standard of credit worthiness that is not related to credit ratings. The Senate Bill would permit an exception to be made if no reasonable alternative standard of credit worthiness could be used, and an amendment to the regulation would be inconsistent with the purposes of the statute that authorized the regulation. **Senate Bill § 939 (pp. 879-884).**

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. 884-885).**

c) Alternative Means for Compensating NRSROs

Both Bills would require the Comptroller to study and to report to the Senate Banking Committee and the House Financial Services Committee 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 (pp. 885-886); H.R. 4173 § 6013 (p. 1264-1271).**

.

d) Feasibility and Merits of Independent Professional 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 (pp. 856-857).** 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).**

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.

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. **Senate Bill § 951 (pp. 899-900); H.R. 4173 § 2002 (pp. 542-45).**

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. 901-08).**

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. 901-08).**

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. 901-08).**

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.

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.

Each issuer will be required to provide for appropriate funding for independent compensation consultants, counsel and other advisors. **Senate Bill § 952 (pp. 901-08); H.R. 4173 § 2003 (pp. 545-51).**

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 (pp. 908-09).**

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 (pp. 909-10).**

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. 910-11).**

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. 911-12).**

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. 912-13); 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. 9132-14).**

E. Strengthening Corporate Governance

Subtitle F 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. 929-32).**

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. 932-33); 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).[12] **Senate Bill § 973 (pp. 933).**

---

[12] 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, the "Consumer Financial Protection Act of 2010," creates a new independent watchdog with the authority to regulate the offering and provision of consumer financial products or services. In contrast to the House financial regulatory reform bill, the March 15 Print creates a Bureau that will be housed inside the Federal Reserve rather than a new freestanding agency.

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 shall seek to implement and enforce Federal consumer financial protection law for the purpose of ensuring that markets for consumer financial products and services are fair, transparent, and competitive. The Bureau is charged with the mission and authority to ensure that consumers are provided with timely and comprehensible information about financial transactions and protected from unfair or deceptive acts and practices. The Bureau's primary functions are conducting financial education programs; collecting, investigating, and responding to consumer complaints; collecting and publishing information about the market for consumer financial products and identifying consumer risks; supervising persons that offer consumer financial products and services; undertaking enforcement actions to address violations of Federal consumer financial law; and issuing rules, orders, and guidance to implement Federal consumer financial law.

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. 1075).**

The Bureau shall seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that markets for consumer financial products and services are fair, transparent, and competitive. **Senate Bill § 1021(a) (p. 1075).**

1. Structure of the Bureau of Consumer Financial Protection

The Bureau would be housed within the Federal Reserve. **Senate Bill § 1011 (p. 1049).** The Director of the Bureau will be appointed by the President and confirmed by the Senate for a five-year term. **Senate Bill § 1011 (p. 1049).**

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 March 15 Print would create a bureau within the Federal Reserve. **H.R. 4173 § 4101.** However, the March 15 Print 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 may not interfere 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 will be subject to approval or review by the Fed. **Senate Bill § 1012(c) (p. 1053).**

3. Consumer Advisory Board

The Director would be required to establish a Consumer Advisory Board. Six of the Board's members will be appointed by the Federal Reserve Bank Presidents. **Senate Bill § 1014 (p. 1063).**

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) (pp. 1055-1058), 1013(c) (pp. 1058-1060), and 1013(d) (pp. 1060-1061).

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) (p. 1075-1076).**

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. 1076-1077).**

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. 1064).**

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) (pp. 1057-1058).**

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. 1064).**

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. 1064).** 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. 1064-1066).**

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) (pp. 1069-1071).**

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 may transfer up to 10% of its combined expenditures in 2011, 11% in 2012, and 12% in 2013 and every year thereafter. **Senate Bill § 1017 (p. 1066-1067).**

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.

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) (pp. 1031-1032).** 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. 1031).**

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) (p. 1035).**

2. Persons and Activities Not Under the Authority of the Bureau

However, activities related to the writing of insurance or the reinsurance of risks are not within the purview of the Bureau. **Senate Bill § 1002(3) (pp. 1030-1031).** In addition, the Bureau does not have authority with respect to credit extended directly by merchants, retailers, or sellers of nonfinancial services exclusively to enable a consumer to purchase a nonfinancial good or service. The Bureau does not have authority over real estate brokerage activities, retailers of manufactured or modular homes, accountants or tax preparers, attorneys, employee benefit and

compensation plans, or persons regulated by a state securities commission. **Senate Bill § 1027(a) (pp. 1114-1117).**

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. 1064).**

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. 1080).** 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. 1080).**

The Bureau would be required to publish at least one report annually of significant findings of its monitoring. **Senate Bill § 1022(d) (pp. 1085-1086).** 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. 1082-1083).**

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. 1077).** 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).**

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 § 1021(b)(2) (p. 1076).**

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 (p. 1075).**

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. **Senate Bill § 1021(b)(1) (p. 1075-1076).**

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 (pp. 1137-1139).**

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. 1086-1087).**

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) (pp. 1091-1092).**

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 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) (pp. 1091-1092).**

Banks with over $10B 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 $10B in assets. **Senate Bill § 1025 (pp. 1101-1102).** For banks with less than $10B in assets, the prudential regulator would have exclusive enforcement authority. **Senate Bill § 1026 (p. 1110).**

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. 1093).**

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. 1094).**

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. 1147-1148).**

F. Enforcement Authority

1. General Enforcement Authority

To the extent that Federal law authorizes both the Bureau and another Federal agency to enforce Federal consumer financial law with regard to a non-depository person, the Bureau would be required to 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 would be required to have primary enforcement authority. 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 (pp. 1169-1170).**

2. Enforcement Authority for Small Banks, Thrifts, and Credit Unions Under $10 billion

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 must respond to the Bureau within sixty days. **Senate Bill § 1025(d) (p. 1112).**

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 (pp. 1170-1174).**

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. 1187).**

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 (pp. –1196-1197).**

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. 1198-1199).**

First tier civil penalties would be limited to $5,000 for each day during which the violation continues. Second tier civil penalties, available when a person recklessly engages in a violation, would be limited to $25,000 for each day during which the violation continues. Third tier civil penalties, imposed for knowing violations, could not exceed $1,000,000 for each day during which the violation continues. The penalty would be required to reflect the size of financial resources and good faith of the person charged, the gravity of the violation, the severity of risks or losses to the consumer, any history of previous violations, and "such other matters as justice may require." The Agency could also make referrals for criminal proceedings to the Attorney General whenever the Agency obtains evidence that a person has engaged in conduct that may constitute a violation of Federal criminal law. **Senate Bill § 1055 (c) (pp. 1200-1201).**

All civil penalties would be placed in the Victims Relief Fund. **Senate Bill § 1017(d)(1) (pp. 1074-1075).**

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. 1202-1204).**

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. 1216-1220).**

H. Preemption Provisions

1. Current Law

From the inception of national banking, state laws regulating national banks have been preempted.[13] The National Bank Act, enacted following the Civil War, vested exclusive control over national banks in the federal government.[14] In short, the "history" of national banking "is

---

[13] *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.").

[14] *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

[Footnote continued on next page]

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."[15]

Under current law, preemption extends to banking activities conducted by an operating subsidiary of a national bank.[16] However, the federal banking laws have been held not to preempt state officials' enforcement of their own fair-lending laws.[17]

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) (pp. 1149-1150).** However, the preemptive effect of "enumerated [federal] consumer laws" is preserved. **Senate Bill § 1041(b) (p. 1150).**

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

---

[Footnote continued from previous page]
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.").

[15] *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).

[16] *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.").

[17] *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").

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. 1150-1152).**

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,[18] with a milder form of "conflict" preemption, in which only conflicting state laws are preempted.[19] The Bill specifies that "more protective" state laws are not in conflict.[20] 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. 1149-1152).**

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. 1152-1153).** 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. 1153-**

---

[18] 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 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.

[19] *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).

[20] 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).

1155). The Director will issue regulations to implement this section and provide guidance for the coordination of action with state regulators. **Senate Bill § 1042(c)**

Section 1042 specifies that no provision of this section should be construed as limiting the authority of a state attorney general or state regulator to bring an action or other regulatory proceeding arising solely under the law of that state. Section 1042 expands upon *Cuomo v. Clearing House* by broadly authorizing state officials to enforce not only state law, but all the provisions of "this Title," including regulations issued under this Title. By giving the Bureau discretionary authority to intervene, this provision recognizes concurrent federal-state authority (rather than exclusive federal authority).

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.

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 (pp. 1156-1157).** 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(a) (p. 1157).** 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) (pp. 1159-1160).**

The Comptroller must make case-by-case preemption determinations in consultation with the Bureau; this duty is non-delegable. The Comptroller must make a written finding that federal law provides a substantive standard governing the particular conduct at issue. Preemption determinations must be made public and periodically reviewed by the Comptroller. **Senate Bill § 1044(b)(3)**

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[21] 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 (pp. 1167-1169).**

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 (pp. 1164-1165).** 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 (pp. 1165-1166).**

9. Effective Date

This subtitle shall take effect on the designated transfer date, 180 days after enactment. **Senate Bill § 1048 (p. 1169).**

---

[21] 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 (pp. 1365-1366).** 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 (p. 1366).**

2. Reports by the Fed to Congress

Finally, the Fed would be required to provide a report to the Senate Banking Committee and the House Financial Services Committee:

- 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 (pp. 1366-1368).**

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 (pp. 1368-1369).**

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 determined 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 (pp. 1369-1371).**

B. GAO Reviews of Special Federal Reserve Credit Facilities

Under the Senate Bill, the 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 (pp. 1371-1373).**

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 (pp. 1373-1375).**

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 (pp. 1376-1377).**

C. 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) (pp. 1377-1378).**

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) (pp. 1378-1379); 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) (p. 1393).**

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) (p. 1379).** 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) (pp. 1379-1380); 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) (pp. 1380-1381).** 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) (p. 1381).** The procedures governing the joint resolution required by Congress are outlined in the Senate Bill. **Senate Bill § 1155(d) (pp. 1381-1390); 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) (pp. 1390-1392).**

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) (pp. 1390-1392); H.R. 4173 § 1109(d).**

D. 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) (p. 1393) 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) (pp. 1394-1395); H.R. 4173 § 1110(b), (c).**

E. 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 (pp. 1395-1396).**

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 (pp. 1395-1396).**

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) (pp. 1396-1397).**

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)
Brian Lane - Washington, D.C. (202-887-3646, blane@gibsondunn.com)
Lewis Ferguson - Washington, D.C. (202-955-8249, lferguson@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)
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)

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, NY (212-351-4050, gschieren@gibsondunn.com)
Mark K. Schonfeld - New York (212-351-2433, mschonfeld@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)