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THE CONTINUING IMPACT OF

Dodd-Frank

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Agenda
June 26, 2013

8:30 a.m.	**Registration and Breakfast**
8:55 a.m. – 9:00 a.m.	**Welcoming Remarks**
9:00 a.m. – 10:15 a.m.	**Derivatives Regulation** This panel will address the recent developments in derivatives regulation. • Update on Dodd-Frank cross-border guidance • The European Market Infrastructure Regulation (EMIR) in the context of Dodd-Frank • Next Steps – regulatory and legislative developments
Panelists:	*Joshua Cohn, Ed Parker and Jerome J. Roche*
10:15 a.m. – 11:30 a.m.	**Developments in Bank Regulation** This panel will address several recent key regulatory initiatives affecting both traditional banking organizations and nonbank financial companies, as well as review the status and prospects for several other important Dodd-Frank provisions. • Recovery and resolution planning (“living wills”) • Enhanced prudential standards for US and non-US Systemically Important Financial Institutions (SIFIs) • Regulatory capital developments • Derivatives push-out provisions
Panelists:	*Scott A. Anenberg, Thomas J. Delaney and Joel Moss*
11:30 a.m. – 11:45 a.m.	**BREAK**
11:45 a.m. – 12:30 p.m.	**The Volcker Rule** This panel will focus on the implementation of the Volcker Rule and the upcoming final regulations. • How are banks coping with good faith conformance planning in the absence of final regulations? • What should we expect to see in final regulations? • Strategies for avoiding covered fund status under the Investment Company Act • International developments, including Vickers and Liikanen
Panelists:	*Alexandria Carr, Stephanie M. Monaco and David R. Sahr*
12:30 p.m. – 1:30 p.m.	**Lunch** Special presentation: US – EU Transatlantic Trade Negotiations and Financial Services
Speaker:	*Timothy J. Keeler*

1:30 p.m. – 2:30 p.m. **The Residential Mortgage Market: Current Trends and Expectations**

This panel will address several of the key regulatory developments affecting the residential mortgage markets (e.g., the CFPB's mortgage-related rules, state licensing and enforcement activities and the potential impact of Basel III capital requirements) and some of the current trends in the secondary mortgage market.

- Potential impact of CFPB's final rules regarding qualified mortgages and servicing standards on originators, servicers and secondary market participants
- Legal and regulatory considerations in connection with the sale or acquisition of seasoned, reperforming and nonperforming residential mortgage loans
- Expectations regarding the securitization of newly originated residential mortgage loans and potential impediments

Panelists: *Chris M. Gavin and Jeffrey P. Taft*

2:30 p.m. – 3:30 p.m. **Cross-Border & International Issues**

This panel will highlight the status of financial reform efforts in the EU and recent developments on the extraterritorial reach of US laws.

- Changes to EU legislation relating to market infrastructure, regulation of investment services and financial instruments, insider dealing laws and capital requirements
- Financial transactions tax
- Recent Supreme Court cases concerning the presumption against extraterritorial application of US law
- Recent developments concerning asset turnover (the *Koehler* doctrine)

Panelists: *Alexandria Carr and Alex C. Lakatos*

3:30 p.m. – 3:45 p.m. **BREAK**

3:45 p.m. – 5:00 p.m. **Recent Developments in Securitization**

This panel will focus on key aspects of the impact of Dodd-Frank on securitization transactions.

- The Basel Committee's proposed new securitization capital framework
- Mortgage securitization developments, including the impact of qualified mortgage rules; qualified residential mortgage loans and risk retention; and Rule 15Ga-1, Rule 193, and other disclosure rules
- Status and update on other recent regulatory developments, including Regulation AB 2 and shelf availability; risk retention, conflicts of interest; the Volcker Rule; current derivatives issues in securitizations and rating agency reforms

Panelists: *Jason H.P. Kravitt, Stuart M. Litwin and Jon D. Van Gorp*

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Derivatives Regulation

Joshua Cohn
Partner

Ed Parker
Partner

Jerome Roche
Partner

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Overview of Title VII of Dodd-Frank

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- Registration requirements for:
  - Swap Dealers (SD) and Security-Based Swap Dealers (SBSD)
  - Major Swap Participants (MSP) and Major Security-Based Swap Participants (MSBSP)
- Substantive regulation of swaps activities, including:
  - Mandatory clearing and trade execution requirements
  - Margin requirements for uncleared swaps
  - Recordkeeping and data reporting requirements
  - Internal and external business conduct standards
  - Large trader reporting and position limits
- Authority for implementing swaps regulation allocated to CFTC (swaps) SEC (security-based swaps), and both together (mixed swaps)

Product Definitions

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- What is a swap?
  - A "swap" is broadly defined to include any transaction involving, on an executory basis, the exchange of payments based on the value of commodities, securities or other financial instruments
- What is a security-based swap?
  - A "security-based swap" (SBS) is defined to include any swap based on a narrow-based security index or on a single security (excluding a US government security, but including non-US government securities) or a loan
- What is a mixed swap?
  - A "mixed swap" is defined as a subset of SBS that also is based on the value of one or more commodities, securities or other financial instruments

Intermediary Definitions

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- A SD or SBSD is a person who engages in any of the following activities:
  - Holding oneself out as a dealer in swaps or security-based swap (SBS)
  - Making a market in swaps or SBS
  - Regularly entering into swaps or SBS as an ordinary course of business for one's own account
  - Engaging in any activity causing oneself to be commonly known in the trade as a dealer or market-maker in swaps or SBS

Intermediary Definitions

THE CONTINUING IMPACT OF Dodd-Frank

- MSP/MSBSP is a non-SD/non-SBSD that meets any of the following criteria:
  - Maintains a "substantial position" in swaps or SBS for any of the major swap or SBS categories, not including positions held for hedging or mitigating commercial risk
  - Outstanding swaps or SBS create "substantial counterparty exposure" that could have serious adverse effects on the financial stability of the US banking system or financial markets
  - A financial entity that is highly leveraged, not subject to US bank capital requirements, and maintains a "substantial position" in any category of swaps or SBS

Update on Dodd-Frank Cross-Border Guidance

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- Key statutory provisions
- CFTC cross-border guidance
- SEC cross-border guidance

Key Statutory Provisions

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- For CFTC, Dodd-Frank section 722(d) provides:
  – "The provisions of [the CEA] relating to swaps that were enacted by [Title VII of the DFA] shall not apply to activities outside the United States unless those activities—

    ''(1) have a direct and significant connection with activities in, or effect on, commerce of the United States; or

    ''(2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of this Act . . . "
- For SEC, Dodd-Frank section 772(b) provides:
  – "No provision of [the Securities Exchange Act of 1934] that was added by [DFA Title VII], or any rule or regulation thereunder, shall apply to any person insofar as such person transacts a business in security- based swaps without the jurisdiction of the United States, unless such person transacts such business in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate to prevent the evasion of any provision [added by DFA Title VII]."

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CFTC Cross-Border Guidance

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- On June 29, 2012, the CFTC released its proposed "interpretive guidance and statement of policy" regarding the cross-border application of the swaps provisions of DFA Title VII
- On December 21, 2012, the CFTC issued a time-limited exemptive order, which expires July 12, 2013, regarding cross-border swap activities
- Key aspects of the above guidance:
  – Definition of US person (still in flux as CFTC has sought comments on further potential modifications)
  – *De minimis* calculation for non-US SDs and threshold calculations for non-US MSPs
  – Treatment of branches and agencies for registration purposes
  – Applicability of substantive swap regulations to non-US registered persons and "substituted compliance" regime

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SEC Cross-Border Guidance

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- On May 1, 2013, the SEC released its proposed rules and interpretive guidance regarding the cross-border application of the security-based swaps provisions of DFA Title VII
  - 90-day public comment period ends on August 21, 2013
  - Also the SEC re-opened for public comment all other proposed SBS rules
- Key aspects of the proposed guidance:
  - Definition of US person (different than CFTC)
  - *De minimis* calculation for non-US SBSDs and threshold calculations for non-US MSBSPs
  - Treatment of branches and agencies for registration purposes
  - Applicability of substantive security-based swap regulations to non-US registered persons and "substituted compliance" regime (a first for SEC)

The European Market Infrastructure Regulation (EMIR) and EU Regulation of Derivatives

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- What is EMIR?
- To whom does EMIR apply?
- Clearing obligation
- Reporting obligation
- Risk mitigation
- Schedule and timeline

What is EMIR?

- Regulation (EU) No 648/2012 of the European Parliament and of the Council of July 4, 2012 on OTC derivatives, central counterparties and trade repositories ("EMIR")
  - Part of the G-20 agenda (April 2009)

    "All standardised OTC derivatives contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end 2012 at the latest.
    OTC derivatives contracts should be reported to trade repositories."
  - Published in Official Journal on July 27, 2012

What is EMIR? (cont.)

esma

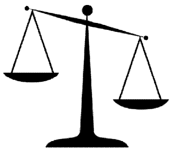
- Majority of subordinate legislation proposed by European Securities and Markets Association (ESMA) adopted by Commission on December 19, 2012:
  - Regulatory technical standards (RTS) – RTS published on February 23, 2013 and in force since March 15, 2013
  - Implementing technical standards (ITS) – ITS published in Official Journal in December 2012 now in force
- There are three main areas of obligations:

→ CLEARING | REPORTING | RISK MANAGEMENT

To Whom Does EMIR Apply?

Entities

- Financial counterparties (FCs)
- Non-financial counterparties exceeding the clearing threshold (NFCs+)
- Non-financial counterparties (NFCs)
- Certain entities from third countries



(1) Clearing Obligation – Eligible Derivatives

Entities:
Only applies to FCs and NFC+s

Obligation:
All eligible derivatives must be cleared by a Counterparty Clearing House (CCP) if contract is between a combination of FCs and NFC+s

Eligible Derivatives :
OTC derivative contracts which ESMA has determined are subject to mandatory clearing obligation (criteria include standardization and liquidity levels)

Clearing Obligation - ET

- Extra-territorial effect
  - EU counterparty + non-EU counterparty
    - Clearing obligation applies provided latter would be subject to clearing obligation if was established in EU
  - Non-EU counterparty + non-EU counterparty
    - Applies provided entities would be subject to clearing obligation if were established in EU, provided that the contract has *"direct, substantial and foreseeable effect within the"* EU *"or where such an obligation is necessary or appropriate to prevent the evasion of any provisions"* of EMIR

(2) Reporting Obligation – All Derivatives Contracts

Entities:
All entities FC, NFC+s and NFCs

Start date for reports	Condition
Credit/interest rate derivatives	
July 1, 2013	If TR for derivative class registered before April 1, 2013
90 days after registration of TR	If condition for registration not fulfilled
July 1, 2015 (reports made to ESMA)	If no TR for derivative class registered by July 1, 2015
Other derivatives	
January 1, 2014	If TR for derivative class registered before October 1, 2013
90 days after registration of TR	If condition for registration not fulfilled
July 1, 2015 (reports made to ESMA)	If no TR for derivative class registered by July 1, 2015

(3) Risk Mitigation

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All entities:
- Timely confirmation
- Portfolio recognition and compression
- Dispute resolution

FCs and NFC+s:
- Daily mark-to-market (or mark-to-model)
- Exchange of collateral

FCs only:
- Additional reporting
- Appropriate capital for uncollateralized risks

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Specific Schedules - Confirmations

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Transactions	Before August 31, 2013	Before February 28, 2014	Before August 31, 2014	August 31, 2014 onwards
Between FCs and NFC+s:				
CDS/IRS	T + 2		T + 1	
Other	T + 3	T + 2		T + 1
With other NFCs:				
CDS/IRS	T + 5	T + 3		T + 2
Other	T + 7	T + 4		T + 2

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Implementation and Compliance Timeline

March 15, 2013:

NFC+s notification

Confirmations

Daily valuations

September 15, 2013:

Portfolio recognition

Portfolio compression

Dispute resolution

Summer 2014:

First clearing obligation starts

Three year phase-in for NFC+s begins

2013												2014							
Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug

Since August 16, 2012:

-Record-keeping:
-Margin:

Q3 2013:

Reporting to TRs for interest rate and credit derivative swaps

Q4 2013:

First CCPs authorized:
-Clearing member obligations
-Frontloading periods start

Jan 1, 2014:

Reporting to TRs for other asset classes starts

Comparison of EMIR to Dodd-Frank Act

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Commonalities	Differences
Mandatory clearing obligation	Volcker Rule
Requirements for uncleared swaps	Swaps "Push-Out" Rule
Reporting requirements	Potential restrictions on ownership of CCPs
CCP requirements	Exchange trading requirement
	Means of delivery of end-client client protection
	Extra-territoriality

Next Steps

- Regulatory and legislative developments

Questions?

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Developments in Bank Regulation

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The Beginning of the End of Global Cooperation?

"For the foreseeable future then, our regulatory system must recognize that while internationally active banks live globally, they may die locally."

Governor Daniel K. Tarullo
Yale School of Management Leaders Forum, November 28, 2012

Proposed Sections 165 and 166 Regulations

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- December 14, 2012 – Federal Reserve Board (FRB) proposes enhanced prudential standards and an early remediation framework for non-US banking organizations (FBOs) and non-US non-bank financial companies
  - Significant departure from current reliance on consolidated supervision by home-country authorities
  - Not tailored to individual systemic footprints, risk profiles or home-country standards
  - 103 specific questions for comment – but are they listening?

Proposed Sections 165 and 166 Regulations (cont.)

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- FBOs with \$50B globally and \$50B or more in US assets would be subject to:
  - Intermediate holding company (IHC) formation with separate capital requirement;
  - Comprehensive Capital Analysis and Review (CCAR);
  - Monthly liquidity stress tests and liquidity requirements for the IHC and branch/agency network; and
  - Single-counterparty credit limits (SCCL), risk management standards, stress test requirements and early remediation requirements

Proposed Sections 165 and 166 Regulations (cont.)

- FBOs with $50B global and $10B to $50B in US assets would be subject to:
  - IHC formation
  - Basel-consistent home-country capital standards
  - SCCL, annual liquidity stress tests and early remediation requirements
  - Company-run stress tests in place of CCAR
- Branch/agency network would be subject to asset maintenance requirement if FBO does not have home-country stress testing

Intermediate Holding Company (IHC) Requirement

- FBOs that have $50B in consolidated global assets and $10B or more in US assets would organize US subsidiaries under a single IHC
  - Branches, agencies and Section 2(h)(2) companies are not included in US assets
  - Non-bank subsidiaries of FBOs that do not have US insured depository institutions included in US assets calculation
  - FRB will monitor attempts to shift assets into branches and agencies to avoid IHC threshold
  - Possibility of multiple IHCs for FBOs with existing foreign IHCs or specific home-country law restrictions

Hypothetical Structure of an FBO Subject to the IHC Requirement

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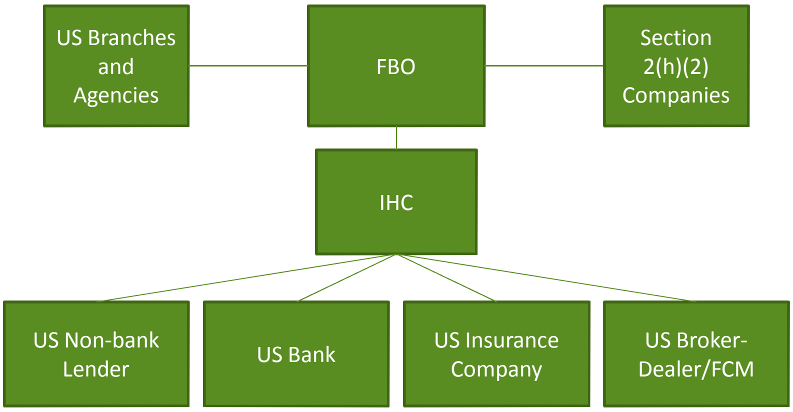

Excludes lower level US holding companies

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Risk-Based Capital and Leverage Requirements

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- Proposal would extend US BHC risk-based capital requirements and leverage limits to all IHCs, regardless of depository institution ownership
  - Would include the general risk-based capital rule, the leverage rule, the market risk rule and, where appropriate, the advanced approaches risk-based capital rule
  - IHCs with $50B must follow CCAR
  - SIFI-IHCs will be subject to capital surcharges
- Non-IHC FBOs with $50B in global assets would need to certify that they meet consolidated home-country Basel III-consistent capital frameworks

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Risk Management and Risk Committee Requirements

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- Risk Committee – Public FBOs with at least $10B in global assets and all FBOs with $50B in global assets would:
  - Need to maintain a committee that oversees US risk management practices
  - If the IHC has $50B in assets and the FBO has no branches, the committee must be at the IHC level
- US Risk Officer – FBOs with $50B in US assets would appoint a US chief risk officer who:
  - Is employed by a US entity
  - Reports to the US risk committee and global risk officer

Liquidity Requirements

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- FBOs with $50B in global assets and less than $50B in US assets would need to:
  - Report annual internal liquidity stress testing for the FBO or the combined (branches/agencies/IHC) US operations
- FBOs with $50B in global assets and $50B in US assets would need to:
  - Conduct monthly stress tests consistent with the proposed US BHC rules and
  - Maintain 14-day domestic and 30-day global liquidity buffers of highly liquid assets (HLAs) for the branch/agency network and a 30-day domestic liquidity buffer for the IHC

Liquidity Requirements (cont.)

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- FBOs with $50B in global assets and $50B in US assets would also need to have:
  - The US Risk Committee review and approve the liquidity risk tolerance of the US operations at least annually
  - The US Chief Risk Officer review and approve liquidity implications of each new line of business, product, and contingency funding plan
  - An independent review function to evaluate the liquidity risk management of the US operations
  - A comprehensive cash flow projection that identifies cash flow mismatches

Single-Counterparty Credit Limits (SCCL)

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- IHCs and combined US operations of an FBO with $50B in global assets would be limited to an aggregate net credit exposure to any single unaffiliated counterparty not to exceed 25% of IHC or FBO capital
- IHCs and combined US operations of an FBO with $500B in global assets would face a stricter limit with respect to counterparties with $500B in global assets
- Federal and FBO home-country sovereign exposures would be exempt, but non-home country foreign or US municipal exposures would not

SCCL – FRB Proposal vs. Basel Committee

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	Federal Reserve	Basel Committee
Limit	25% for FBOs w/ $50B global & IHCs; stricter for FBOs and IHCs w/ $500B and a $500B counterparty	5% large exposure monitoring; 10%-15% for G-SIB to G-SIB exposures; 25% for all others
Counterparty Aggregation	Counterparty and subsidiaries in which counterparty holds of 25% of voting securities or 25% of equity or has consolidated financials	Counterparty, directly and indirectly controlled parties, economically interdependent parties, and exposures to credit protection providers
Excluded/ Exempt Exposures	Federal government, Fannie/ Freddie while under conservatorship, intra-day and settlement exposures	Not addressed
Measurement Methods	CEM for OTC derivatives; add-on approach for SFT	CEM for OTC derivatives; comprehensive approach for SFT

Stress Test Requirements

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- IHCs with $50B in assets would be subject to CCAR and mid-cycle company stress test requirements
- IHCs with $10B to $50B in assets would be subject to an annual company stress test requirement
- FBOs with $50B in US assets that lack home-country stress tests would need to maintain 108% asset coverage in their US branch/agency network
- FBOs with $10B to $50B in US assets that lack home-country stress tests would need to maintain 105% asset coverage in their US branch/agency network

Early Remediation Framework and Debt-to-Equity Limits

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- FBOs with $50B in US assets would be subject to four-level early remediation framework that would include enforcement action, US branch asset maintenance requirements and IHC director/officer replacement
- FBOs with less than $50B in US assets would be subject to the early remediation framework on a discretionary basis
- If FSOC determines an FBO or IHC poses a grave threat to US financial stability, the FRB will impose a 15-to-1 debt-to-equity ratio on the IHC or other US subsidiary of the FBO and a 108% asset maintenance requirement on the FBO's US branch/agency network

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Comments & Reactions

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- Comment period closed March 31, 2013
- 60 comments submitted
- Generally critical of the proposal's departure from the existing regulatory approach:
  - Expressing uncertainty regarding how IHC creation and operation will interfere with resolution planning
  - Concerned with the proposal's high cost to implement and negative impact on liquidity and global financial stability

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Post-Comment Period Closure Activities

- Foreign regulators have also expressed concern regarding:
  - The proposal's selection of ring-fencing assets in the US approach instead of the Financial Stability Board's single-point-of-entry approach
  - The proposal's one-size-fits-all approach instead of an approach tailored to an FBO's footprint, profile and home-country regulator
  - The negative effect the proposal's territorial approach will have on cross-border resolutions and global capital formation
  - The proposal's discriminatory impact on FBOs relative to domestic BHCs

Purpose of Dodd Frank's Resolution Plan Requirement

- Section 165(d) of Dodd Frank requires certain large systemically important financial institutions defined as "Covered Companies" to prepare Resolution Plans (a/k/a "Living Wills")
  - Note that certain large insured depository institutions (IDIs) are required to submit Resolution Plans pursuant to a separate Resolution Plan requirement for IDIs (the parent of the IDI may also be required to submit a section 165(d) Resolution Plan that includes the IDI)
- Resolution Plans are designed to provide the FRB and Federal Deposit Insurance Corporation (FDIC) with (i) information regarding a financial institution's operations as well as (ii) the institution's strategy for mitigating risk to the US economy in the event of the institution's failure

Purpose of Dodd Frank's Resolution Plan Requirement (cont.)

- The implementation of Resolution Plans under Dodd Frank is aimed to promote systemic financial stability by:
  - Enhancing the oversight and supervision of financial institutions
  - Enhancing risk management capabilities and risk mitigation
  - Increasing market confidence
- The resolution planning requirement is a direct outgrowth of the Lehman bankruptcy
  - Lehman was deemed by some to be a disorderly resolution because, among other things, (i) the trustees and administrators appointed over Lehman's assets lacked access to certain key information and (ii) cross-jurisdictional cooperation was lacking in certain respects

Who Has to File Resolution Plans?

- It is estimated that there are 124 banking firms (approximately 90 of which are headquartered outside of the US) deemed "Covered Companies" and subject to Dodd-Frank resolution planning
  - This estimate does not include non-banking institutions
- Just this month, AIG, Prudential Financial and GE Capital were designated as non-bank financial companies subject to supervision by the Federal Reserve and, as a result, such institutions will have to submit section 165(d) Resolution Plans
  - Additional entities may also be designated as non-bank financial companies subject to supervision by the Federal Reserve

What Entities Must File Section 165(d) Resolution Plans?

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- "Covered Companies," as defined under the Resolution Plan final rule, are those institutions required to submit Resolution Plans
- Covered Companies include:
  - Any US or foreign bank holding company or company that is treated as a bank holding company that has total consolidated global assets of $50 billion or more
  - Any non-bank financial company designated by the Financial Stability Oversight Council for supervision by the Federal Reserve
  - Controlling corporate shareholders that own 25% of more of a foreign bank (which raises difficult issues for some foreign banks)

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Resolution Plan Submission Deadlines

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- **First-round filers** = US and foreign-based Covered Companies with the largest non-bank operations and presence ($250 billion or more total global non-bank assets for domestic Covered Companies and $250 billion or more in total US non-bank assets for foreign Covered Companies)
  - Submitted initial Resolution Plans on July 1, 2012; must submit annually thereafter
  - Were to have submitted updated 2013 Resolution Plans on July 1, 2013 (deadline extended to October 1, 2013, based on additional guidance from regulators)
  - 11 major US bank holding companies and foreign banking organizations regulated as bank holding companies submitted plans in 2012: Bank of America Corporation, Barclays PLC, Citigroup Inc., Credit Suisse Group AG, Deutsche Bank AG, The Goldman Sachs Group, JPMorgan Chase & Co., Morgan Stanley and UBS AG
    - Bank of New York Mellon Corporation and State Street Corporation were subsequently treated as first-round filers and they submitted initial Resolution Plans on October 1, 2012

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Resolution Plan Submission Deadlines (cont.)

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- **Second-round filers** = US and foreign-based Covered Companies with more than $100 billion, but no more than $250 billion total global non-bank assets for domestic Covered Companies (and more than $100 billion, but no more than $250 billion total US non-bank assets for foreign based Covered Companies)
  - To submit Resolution Plans on July 1, 2013; must submit annually thereafter
  - Second-round filers include Wells Fargo, BNP Paribas, HSBC and RBS
- **Third-round filers** = Remaining Covered Companies with less than $100 billion in total global non-bank assets for domestic Covered Companies (and less than $100 billion in total US non-bank assets for foreign Coved Companies)
  - To submit Resolution Plans on December 31, 2013; must submit annually thereafter

Resolution Plan Requirements Generally

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- Resolution Plans must include both a public section and confidential section
  - Public sections are posted on the Federal Reserve and FDIC websites
- The Resolution Plan final rule is focused on material entities, core business lines and critical operations
  - Material Entities: subsidiary or foreign office (e.g., branch) of a Covered Company that is "significant" to the activities of a "core business line" or "critical operation"
  - Core Business Lines: those business lines of the Covered Company, including associated operations, services, functions and support that, in the view of the Covered Company, upon failure, would result in material loss of profit, revenue or franchise value
  - Critical Operations: those operations of the Covered Company, including associated services, functions and support, the failure or discontinuance of which, in the view of the Covered Company or as jointly directed by the Federal Reserve and FDIC, would pose a threat to the financial stability of the US (e.g., clearing operations, settlement operations, depending on size and importance to the US economy)
- Initial plan submissions must assume "baseline" economic conditions while subsequent submissions must assume financial distress under "baseline," "adverse" and "severely adverse" economic conditions

Resolution Plan Requirements Specifically

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- Resolution Plans must include:
  - Executive summary: highlighting key material changes and company actions taken since previous resolution plan was filed and summarizing Resolution Plan
  - Strategic analysis: actions to be taken to facilitate a rapid and orderly resolution for all "material entities," "core business lines" and "critical operations"- must include, among other things, a description of (i) key assumptions and supporting analysis underlying the Resolution Plan, (ii) planned actions, funding, liquidity and capital needs, (iii) strategy for maintaining operations and funding and (iv) potential weaknesses to effective and timely execution of plan
    - Note that strategic analysis does not need to be undertaken for any material entity that is subject to an insolvency regime other than the US Bankruptcy Code unless entity (a) has $50 billion or more in total assets and/or (b) conducts a critical operation
  - Corporate governance: structures, policies, procedures and internal controls, including how resolution planning is integrated into corporate governance

Resolution Plan Requirements Specifically (cont.)

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- Resolution Plans must include (cont.):
  - Organizational structure: financial information that identifies all material legal entities, maps core business lines and critical operations to such entities, sets forth detailed descriptions of material on and off balance sheet exposure, financial positions, booking and hedging practices, major counterparties and trading, payment, clearing and settlement systems
  - Management and information systems: description and inventory of key management and information systems (e.g., risk management and accounting), including the legal owner and licensor of such systems, use or function of the system and application and any related service level agreements and IP, ability to collect, maintain and report information and data to the regulators, mapping of key management information systems and applications to material entities, core business lines and critical operations that use or rely on such systems or applications
  - Interconnectedness and interdependencies: mapping the interconnections and interdependencies among material entities, core business lines and critical operations that, if disrupted, would materially affect funding or operations, including: (i) common or shared personnel, facilities or systems, (ii) capital funding or liquidity arrangements, (iii) existing or contingent credit exposures, (iv) cross-guarantee arrangements, cross-collateral arrangements, cross default, cross-affiliate netting, (v) risk transfers and (vi) service level agreements

Consequences of Non-Compliance with Resolution Plan Requirement

THE CONTINUING IMPACT OF Dodd-Frank

- Failure of a financial institution to submit a "credible" Resolution Plan may result in the regulators imposing more stringent capital, leverage and/or liquidity requirements or restrictions on growth until such Resolution Plan deficiencies are remedied
- In addition, if Resolution Plan deficiencies are not remedied within two years after imposition of any of the above sanctions, the Federal Reserve and FDIC can order an institution to divest assets

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Tailored Plans

THE CONTINUING IMPACT OF Dodd-Frank

- Covered Companies that have less than $100 billion in total global non-bank assets (or US non-bank assets in the case of a foreign Covered Company) where bank assets (e.g., depository institution assets) comprise 85% or more of the Covered Company's total consolidated assets (or, in the case of a foreign based Covered Company, the US depository institutions, branches and agencies of the foreign Covered Company comprise 85% or more of the Covered Company's US total consolidated assets) may submit a "tailored" Resolution Plan
- Institutions were required to request by April 2013 permission from the Federal Reserve and FDIC to file a tailored plan and have largely been told whether those requests have been accepted
- Tailored plans allow an institution to satisfy certain Resolution Plan requirements by providing information for non-bank assets and operations only (e.g., for the strategic analysis)
- In practice, particularly for foreign-based Covered Companies with no critical operations or virtually no US non-bank assets, key issue will be how "tailored" of a tailored plan will be acceptable

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Lessons Learned From Initial Resolution Plans Filed

THE CONTINUING IMPACT OF Dodd-Frank

- The resolution planning process will likely develop and evolve with regulators expecting more detailed plans in subsequent submissions
- On April 15, 2013, the Federal Reserve and FDIC publicly released significant formal feedback on the Resolution Plan submissions for institutions that filed their initial Resolution Plans in 2012
- In addition to providing brief guidance on how institutions should address the addition of "adverse" and "severely adverse" economic scenarios required to be assumed, the guidance sets out significant additional content requirements for first-round filers
- To provide first-round filers time to address the new guidance, the regulators extended the filing deadline for first-round filers' 2013 submissions from July 1, 2013 to October 1, 2013
- It remains to be seen what elements of the guidance regulators will expect to see in Resolution Plans of second- and third-round initial filers
- Separate guidance was issued for US and foreign-based first-round filers, but the guidance is substantially the same

Derivatives Push-Out

THE CONTINUING IMPACT OF Dodd-Frank

- Section 716 of Dodd-Frank effectively requires certain US banks and US branches/agencies of non-US banks to transfer certain swap activities to an affiliate
  - Accomplished by prohibiting advances from FRB's discount window and other "federal assistance" (including FDIC insurance) to any "swaps entity" and excluding affiliates from prohibition
  - Scope of federal assistance is very broad and includes uninsured US branches/agencies
  - Only US and non-US banks that are registered swap or security-based swap dealers (or major swap (or security-based swap) participants in case of non-US banks) are covered as "swaps entity"

Derivatives Push-Out (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Effective July 16, 2013
  - Up to three-year transition period with regulatory approval
  - Pre-transition period swaps grandfathered
- Certain swap activities are exempt from push-out (i.e., they can be conducted by the bank)
  - Interest rate and currency swaps
  - Swaps based on reference assets that banks can invest in/trade directly (e.g., precious metals, investment securities)
    - But not non-cleared CDS
  - *Bona fide* hedging directly related to bank's activities

Derivatives Push-Out (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Three big issues
  - Treatment of uninsured branches/agencies
  - Transition period of up to three years
  - Operational/customer issues
- Treatment of uninsured branches/agencies
  - Subject to prohibition because eligible for Fed discount window
  - But, exempted swaps, transition period/grandfathering and exemption of MSPs from treatment as swaps entity available only to "insured depository institutions"

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Derivatives Push-Out (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Treatment of uninsured branches/agencies (cont.)
  - Major concerns because of impact on markets/institutions and lack of national treatment
  - Acknowledged by drafters of Section 716 as drafting error during Dodd-Frank and pending bills would correct
  - FRB to the rescue
    - June 5, 2013 interim rule treating uninsured branches/agencies as "insured depository institution" for purposes of push-out provisions
      - Based on somewhat strained interpretation of statutory language, bolstered by congressional intent, policy arguments and, most importantly, practical considerations
    - So, uninsured branches/agencies now eligible for same exempted swaps, transition period/grandfathering and exemption of MSPs

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Derivatives Push-Out (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Transition Periods
  - Section 716: primary regulator (in consultation with CFTC and SEC) "shall permit" up to two-year transition period for non-exempted swaps
    - Can be extended up to one additional year
  - In determining length of transition period, regulators must take into account potential impact of push-out on institution's mortgage lending, small business lending, job creation and capital formation compared to potential negative impact on insured depositors and FDIC fund

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Derivatives Push-Out (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Transition Periods (cont.)
  - OCC published regulations on January 8, 2013; FRB interim rule on June 5, 2013
    - OCC somewhat more positive tone
      - Determination that transition periods "should be provided"
      - "Prepared to consider requests favorably"
      - Already approved some requests
    - Both require written requests addressing statutory factors (impact on institution vs. FDIC fund and depositors)
      - OCC specifically references operational risks and other safety and soundness concerns; FRB refers to them in justification for no notice/comment
    - Both require institution to request specific period of up to 24 months

Derivatives Push-Out (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Transition Periods (cont.)
    - Both require plan for compliance
  - US branch/agency considerations
    - No adverse affect on insured depositors of FDIC fund
    - Mortgage and small business lending may be less compelling
- Even with approved transition, lots of operational and customer issues

US 2012 Capital Proposals: Overview

- June 2012 – FRB, FDIC and OCC release three NPRs and one final rule (published in August 30 Federal Register)
  - NPR 1 - US Basel III numerator (all banks)
  - NPR 2 - US standardized approach denominator (all banks)
  - NPR 3 - US advanced approaches denominator (largest banks)
  - Final amendments to US Market Risk Capital Rule (banks with significant trading activities)

US 2012 Capital Proposals: Overview (cont.)

- June 2012 – FRB, FDIC and OCC release three NPRs and one final rule (cont.)
  - Complete restatement of US capital rules; greater uniformity
  - Implement Basel III, create US Basel II Standardized and incorporate Basel 2.5
  - Incorporate Dodd-Frank provisions, including Collins amendment, ratings ban, savings and loan holding companies
  - Significant increase in minimum capital requirements and complex transition rules
  - No liquidity rules

US 2012 Capital Proposals: Comments

- Comments were initially due September 7, 2012; extended to October 22, 2012
  - Over 1,000 substantive comments
  - Comments still being submitted as late as May 2013
  - Industry comments lengthy and highly critical
  - November 9, 2012: agencies announce final rules will not be in place to meet targeted January 1, 2013 effective date

US 2012 Capital Proposals: Comments (cont.)

THE CONTINUING IMPACT OF
Dodd-Frank

- Big picture comments
  - Impact on credit availability/economy
  - Competitiveness/departures from BCBS framework (e.g., residential mortgages; securitizations; impact of other Dodd-Frank provisions such as Volcker, Collins, enhanced supervisory standards)
  - Delay implementation
  - Need for QIS, especially on standardized proposal
  - Excessive complexity, especially for community banks

US 2012 Capital Proposals: Comments (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Specific issues
  - Residential mortgage loans: 35-200% based on LTV, underwriting/terms, first vs. second; grandfathering
  - Unrealized gains and losses
  - Higher risk-weights for HVCRE and past-due
  - Floors for derivatives exposure and collateral recognition
  - Calculation of derivatives exposure
  - MSRs
- Current status

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Global Implementation

THE CONTINUING IMPACT OF Dodd-Frank

- BCBS Regulatory Consistency Assessment Program
  - Level 1: ensuring the timely adoption of Basel II/III
  - Level 2: ensuring regulatory consistency with Basel II/III
  - Level 3: ensuring consistency of risk-weighted asset (RWA) outcomes

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Global Implementation (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- April 2013 progress report
  - Level 1 adoption: Basel II (24/27); Basel 2.5 (22/27); Basel III (11/27)
  - Level 2 consistency: Japan & Singapore final assessments; EU & US preliminary assessments; Switzerland & China assessments in progress; Australia, Brazil and Canada assessments will begin later in 2013

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Global Implementation (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- April 2013 progress report (cont.)
  - Level 3 outcomes: Trading book analysis complete; banking book analysis in progress
    - January 2013 – Level 3 analysis of risk-weighted assets for market risk (mRWA) for 16 global banks' trading book assets revealed significant variation
    - Key contributing factors to mRWA variation were differences in market risk methodology (supervisory decisions), modeling choices (bank decisions), the composition of trading assets and accounting requirements and practices
    - Also indications that ratio of overall RWA to total assets varies widely among the 16 banks, ranging from 22% to 75%

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Global Implementation (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Recent BCBS proposals
  - December 2012: proposed fundamental changes to securitization framework (discussed on later panel)
  - March 2013: recognizing cost of credit protection proposal
    - Would require banks to (i) apply 1250% RW to discounted present value of credit protection premiums if protected assets have RW greater than 150%; and (ii) consider present value of premiums in considering level of risk transfer in synthetic securitization

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US Capital Plans and Stress Testing

THE CONTINUING IMPACT OF Dodd-Frank

- CCAR vs. Dodd-Frank stress tests (DFAST)
  - Both include supervisory and company-run stress tests; DFAST uses standardized capital action adjustments (e.g, no changes in dividend levels), CCAR uses company's own plans
  - CCAR has qualitative assessment of capital planning; DFAST is purely quantitative
  - CCAR is annual; DFAST is semi-annual
  - Both involve disclosure of supervisory stress test results; CCAR includes disclosure of FRB decision on capital plan
  - DFAST pre-tax net income forms the basis for CCAR post-stress capital levels and ratios

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US Capital Plans and Stress Testing (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- March 2013 – CCAR review results announced
  - 14 banks passed; 2 conditionally passed; 2 failed
    - All BHCs could adjust proposed distributions after preliminary CCAR post-stress capital analysis (not just if rejected)
    - FRB released nature, but not details, of objections
    - New Model Validation Council provides independent views
    - More model specifications released; risk of "model monoculture"
  - CapPR: 11 next largest BHCs with $50B or more in assets submitted capital plans and company-run stress tests, but no supervisory stress tests or public disclosure of test results

Liquidity Coverage Ratio (LCR)

THE CONTINUING IMPACT OF Dodd-Frank

- January 2013 – BCBS LCR revisions
  - Expanded definition of highly liquid assets to include Level 2B assets (unencumbered equities and A+ to BBB- corporate debt with a 50% haircut and AA or better RMBS with a 25% haircut)
    - Level 2B assets may make up no more than 15% of highly-liquid assets and are included the 40% Level 2 assets limit
  - Relaxed some of the liquidity stress period run-off assumptions
  - Clarified that banks may dip below the minimum LCR requirement during periods of stress
  - Extended phase-in periods
  - NSFR still under construction with a 2018 target date

Liquidity Coverage Ratio (LCR) (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- FRB Section 165 liquidity coverage ratio proposals take a more flexible approach
  - Would not apply haircuts, caps or categories to different types of high-quality liquid assets
  - Would not provide run-off assumptions for net cash outflows during liquidity stress events (rely on stress testing)
  - Qualitative standards rather than prescriptive lists of eligible assets

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Global Systemically Important Banks (G-SIBS)

THE CONTINUING IMPACT OF Dodd-Frank

- November 2012 – FSB progress report and designations
  - Annual G-SIB provisional designations updated: BBVA and Standard Chartered added; Dexia, Commerzbank, and Lloyds removed
    - Each G-SIB assigned to capital surcharge bucket (1-2.5%)
    - Final designations in November 2014; surcharges phased in from 2016-2019
  - FRB signaled in Section 165 and advanced approaches NPR that it would implement G-SIB surcharges according to the FSB schedule

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Domestic Systemically Important Banks (D-SIBs)

THE CONTINUING IMPACT OF Dodd-Frank

- October 2012 – D-SIB framework released by BCBS
  - Scales down the G-SIB regime for the impact that the distress or failure of banks would have on a domestic economy
    - Higher capital and enhanced supervision
    - Arrangements for home-host country coordination
    - Keyed to same timeline as G-SIB regime
  - FRB has not released a US D-SIB proposal, but is taking steps to identify them
    - Use $50B threshold for enhanced prudential standards?

Capital Issues are Still Evolving

THE CONTINUING IMPACT OF Dodd-Frank

- Use of regulatory capital to accomplish policy goals: e.g., shrink the big banks, too-big-to-fail
- Simplicity vs. sophistication
- Leverage ratio vs. risk-based regime
- How much is enough?

Next Steps

THE CONTINUING IMPACT OF Dodd-Frank

- US – Finalizing the Basel NPRs, proposing LCR, identifying D-SIBs, implementing G-SIB and D-SIB surcharges
- BCBS – Finalizing leverage ratio (disclosure starting in 2015 and migration to Pillar 1 in 2018) and securitization framework revisions, trading book revisions, continuing work on NSFR and Level 2 assessments
- FSB – G-SIB designations updated in November 2013 and finalized in November 2014

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Questions?

THE CONTINUING IMPACT OF Dodd-Frank

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Tab 4

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The Volcker Rule

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THE CONTINUING IMPACT OF
Dodd-Frank

Volcker Rule

THE CONTINUING IMPACT OF
Dodd-Frank

- Volcker Rule prohibits a “banking entity” and its “affiliates” on a global basis, unless an exemption is available, from:
  - “Proprietary trading” in securities, derivatives and other instruments
  - Acquiring “ownership interests” in private equity and hedge funds (“covered funds”)
  - Sponsoring covered funds
  - Lending and other “covered transactions” with covered funds for which the banking entity serves as investment adviser, investment manager or sponsor (arms-length conditions imposed on other transactions with such funds)

Status of Regulatory Implementation of Volcker Rule

THE CONTINUING IMPACT OF Dodd-Frank

- Proposed regulation issued in October 2011; comment period long over
- Final regulation appears unlikely to be issued before Fall 2013; it could slip into 2014
- Statute was effective on July 21, 2012
- Two-year conformance period scheduled to expire on July 21, 2014; Fed issued final regulation on implementation of conformance period in February 2011
- Federal Reserve Board issued policy statement in April 2012 on making good faith efforts to plan for conformance by July 21, 2014

What Banking Entities Need to be Doing Now

THE CONTINUING IMPACT OF Dodd-Frank

- Make good faith planning efforts appropriate for affected activities and investments to enable them to conform to the statute and the final regulations by the end of the conformance period
  - Assess existing and new activities and investments for impact of Volcker Rule
  - Develop/implement specific conformance plans on how the firms will conform their activities by July 21, 2014
  - Assess areas (e.g., fund relationships that pre-existed Dodd-Frank) where requests for extension may be appropriate

What Do We Expect to See in Final Regulations?

THE CONTINUING IMPACT OF Dodd-Frank

- Principles-based regulation?
- More strict final regulations based on the proposal?
- Final regulations that are based on, but an improvement over, the proposed regulations?
- Specific issues
  - Hedging?
  - Extraterritorial impact?
  - Use of metrics?
  - Extension of conformance period?

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Definition of Covered Fund

THE CONTINUING IMPACT OF Dodd-Frank

- "Covered Fund" is (i) any issuer that would be an investment company as defined in the Investment Company Act of 1940, but for section 3(c)(1) or 3(c)(7) of the Act or (ii) any "similar funds" determined by the agencies
  - Is the issuer an investment company as defined in the Act?
  - If yes, does it rely solely on the exclusions in section 3(c)(1) or 3(c)(7)?
  - If no, are there other exclusions that might apply?

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Definition of Covered Fund (cont.)

THE CONTINUING IMPACT OF
Dodd-Frank

- The other "similar funds," which we will not be specifically discussing today, are:
  - Any foreign issuer if it would have to rely on section 3(c)(1) or 3(c)(7) if it had been offered in the US, a foreign "equivalent" fund
  - A "commodity pool" as defined in the Commodity Exchange Act
- NB: Even if a fund is excluded from the investment company definition because it does not rely solely on sections 3(c)(1) or 3(c)(7), it must also be determined if it is caught by the commodity pool definition

Dodd-Frank Act Amended Definition of Commodity Pool

THE CONTINUING IMPACT OF
Dodd-Frank

- "Commodity Pool" – any investment trust, syndicate or similar form of enterprise operated for the purpose of trading in commodity interests, <u>including swaps</u>
- Commodity Pool Operator (CPO) modified to include a person engaged in a business operating a commodity pool and who solicits or receives funds or property for the purpose of trading in commodity interests, including swaps
- Key change is inclusion of swaps as commodity interests

Exemptions From Covered Fund Prohibition

THE CONTINUING IMPACT OF Dodd-Frank

Not an investment company in the first instance

- A fund is an investment company if it:
  - Is engaged primarily in the business of investing, reinvesting or trading in securities
  - Is engaged in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities (i.e., all securities except government securities and securities issued by majority-owned subsidiaries) and having a value exceeding 40% of its total assets (exclusive of government securities and cash items) on an unconsolidated basis

Exemptions From Covered Fund Prohibition (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- In determining if a fund is an investment company, it is important to recognize the broad definition of security and what might not be a security.
  - For example, fee interests in real estate (although a mortgage or lien is a security for this purpose) are not securities. Typically, joint venture interests that confer control to the owner may not be securities. No more than 40% of the fund's total assets can be invested in securities and then, its primary source of income should not be from securities holdings

Exemptions From Covered Fund Prohibition (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

If a fund comes within one of those definitions, must it rely on Section 3(c)(1) or 3(c)(7) to be excluded?

- Section 3(c)(1) excludes a fund from the definition if its outstanding securities are beneficially owned by not more than 100 persons and it does not make or plan to make a public offering of its securities. Most issuers relying on this confine their offerings to conform to the requirements of Regulation D under the Securities Act of 1933, typically Rule 506 that currently prevents the use of any general advertisements or solicitations of interests (but consider JOBS Act proposed rule to remove this requirement)
- Section 3(c)(7) excludes a fund from the definition if its outstanding security holders are all qualified purchasers (generally those who own $5 million or more in investments for natural persons and family trusts and $25 million or more for entities) and it does not make or plan to make a public offering of its securities

Reliance on Exclusions Other Than 3(c)(1) or 3(c)(7)

THE CONTINUING IMPACT OF Dodd-Frank

- Section 3(c)(3) exclusion for any common trust fund or similar fund maintained by a bank that is exclusively for the collective investment and reinvestment of moneys contributed by the bank in its capacity as a trustee, executor, administrator or guardian
- Section 3(c)(5)(C) exclusion for funds that primarily invest in mortgage loans and other real estate interests
- Section 3(c)(11) exclusion for any collective trust fund maintained by a bank consisting solely of assets of one or more pension or profit-sharing trusts, government plans or church plans

Exclusion under Section 3(c)(3) for Collective Investment Funds Requirements

- A bank sponsors the collective investment fund (CIF) solely as an aid to the administration of trusts, estates or other accounts created and maintained for a fiduciary purpose
- Interests in the CIF are not advertised or offered for sale to the general public except in connection with the ordinary advertising of the bank's fiduciary services
- Fees and expenses charged by the CIF do not violate fiduciary principles established under applicable federal or state law

Exclusion under Section 3(c)(5)(C) for Real Estate Funds Requirements

- The fund cannot issue a redeemable security
- The fund must be primarily engaged in purchasing or otherwise acquiring mortgages and other liens on and interests in real estate
- Mortgages are notes and they are securities under the Investment Company Act
- Liens are obligations evidencing indebtedness and they are securities under the Investment Company Act
- The SEC staff issued a concept release in August 2011 seeking comments on positions it has taken regarding the scope of the exclusion. To date, no formal action has been proposed or taken

Redeemable Securities Finding

THE CONTINUING IMPACT OF Dodd-Frank

A Section 3(c)(5)(C) fund may not issue redeemable securities

- Factors supporting a redeemable securities finding:
  - Structure modeled after an open-end fund – securities are fully redeemable at the option at the holder upon presentation
  - Security redeemable by a third party acting as agent for the issuer
- Factors not supporting a redeemable securities finding:
  - Substantial time period limits and notice requirements placed on withdrawals (e.g., no withdrawals permitted within the first six to 12 months; thereafter withdrawals are only permitted on a limited basis (i.e., withdrawals are only permitted on a quarterly or semi-annual basis and holder must give 90-day prior written notice))

Redeemable Securities Finding (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Factors not supporting a redeemable securities finding (cont.)
  - Limits to the amount or size of withdrawal (e.g., only a certain percentage as opposed to the proportional ownership interest, withdrawal only permitted if cash is available, etc.)
  - No obligation on the part of issuer to redeem any or all of the securities tendered

Additional Section 3(c)(5)(C) Requirements

THE CONTINUING IMPACT OF Dodd-Frank

- At least 55% of its total assets must consist of qualifying interests, including mortgage loans fully secured by real estate, fee interests in real estate, second mortgages secured by real property, deeds of trust on real property, installment land contracts and leasehold interests secured solely by real property.
  - Tier 1 real estate mezzanine loans, under certain conditions, may be considered a qualifying interest if the loan may be viewed as being the functional equivalent of, and provide its holder with the same economic experience as, a second mortgage. Qualifying interests also include “whole pool certificates” that are issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae (“agency whole pool certificates”).
  - Qualifying interests could also include (although not free from doubt) participation interests in construction period mortgage loans acquired from mortgage lenders and possibly bridge loans, certain construction and rehabilitation loans, wrap-around mortgage loans and investments in distressed debt, provided that the loans are fully secured by real estate.

Additional Section 3(c)(5)(C) Requirements (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Of the remaining 45% of its total assets, 25% must consist of “real estate-related” assets such as agency partial pool certificate (which is a certificate that represents less than the entire ownership interest in a mortgage pool), certificates issued by pools that hold whole loans and participation interests in loans that are secured by commercial real estate (“CMBS")

Section 3(c)(11) Exclusion Requirements

THE CONTINUING IMPACT OF Dodd-Frank

Exclusion under Section 3(c)(11) for collective investment trusts (CITs) requirements:

- The basis for the exclusion is the existence of regulation by bank regulatory authorities of trust and other fiduciary functions of banks
- The collective trust can only consist of assets of trusts for employees' stock bonus, pension or profit-sharing plans that are qualified under Section 401 of the Internal Revenue Code
- The collective trust must be "maintained by a bank," meaning it must exercise "substantial investment responsibility" over the collective trust. Thus, it cannot perform merely custodial or similar functions

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Section 3(c)(11) Exclusion Requirements (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- When and how can a bank hire a third-party investment manager – externally managed CITs
  - The bank must have final authority as to whether or not to invest on behalf of the collective trust
  - The bank must have the ability to determine on an ongoing basis that the investments appropriately carry out the investment objectives of the collective trust
  - The bank must have full and complete authority to determine the **specific securities purchased**, retain discretion to accept or reject the advice of any investment advisor and have officers and appropriate staff to make such decisions

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Additional Exemptions from Covered Fund Definition

THE CONTINUING IMPACT OF Dodd-Frank

- Of course companies that register with the SEC are also exempt from the definition of covered fund under the Volcker Rule
  - For example, registered closed-end funds
  - There has also recently been interest in the business development company (BDC) option
    - A BDC is regulated under the Investment Company Act, but enjoys more liberal requirements than those applicable to other registered funds that relate to its capital structure, affiliated transactions and fees its management company can impose
    - At least 70% of its assets must be invested in eligible portfolio companies and certain other securities
    - The BDC must give significant managerial assistance to those eligible portfolio companies
    - The remaining 30% of a BDC's assets have to be invested in a manner consistent with the Small Business Investment Incentive Act of 1980 and other Investment Company Act restrictions

Additional Exemptions from Covered Fund Definition (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- There are many other exclusions or exemptions from being a covered fund that we did not get to today including, e.g., the Rule 3a-7 exemption for certain securitization issuers
- If a fund ultimately must rely solely on 3(c)(1) or 3(c)(7), it may still find an exemption under final regulations implementing the Volcker Rule

The UK – Vickers: What Did He Propose?

THE CONTINUING IMPACT OF Dodd-Frank

- A ring-fence to separate retail and investment banking
  – A ring-fenced body is a UK institution which carries out one or more "core activities“ (i.e., deposit-taking)
  – A ring-fenced body may not perform certain excluded activities (i.e., “dealing in investments as principal”)
- Dealing in investments as principal vs. proprietary trading
- Enacted in Banking Reform Bill which is currently going through Parliament

The UK – Banking Reform Bill: What Else?

THE CONTINUING IMPACT OF Dodd-Frank

- Ring-fence electrified: regulator can enforce full separation if non-compliance
- Possibility of further restrictions on ring-fenced bodies
- Primary loss-absorbing capacity (PLAC) requirements, i.e., a power to enable HM Treasury to require ring-fenced bodies, other deposit-takers or members of deposit-taking groups to issue any debt instrument or ensure any part of its debt consists of debt instruments
- Power to introduce ring-fencing for building societies
- Depositor preference in case of bank insolvency

The UK – Vickers: Where Are We Now?

THE CONTINUING IMPACT OF
Dodd-Frank

- Bill introduced into Parliament on February 4, 2013
- Government's aim: have legislation enacted by the end of this Parliament (2015) and in place by 2019
- Tyrie Commission on Banking Standards also examining whether changes in areas such as corporate governance, competition, the regulatory and tax framework and the civil and criminal law could enhance standards and improve behavior in the banking industry

The EU – Liikanen: What Did He Propose?

THE CONTINUING IMPACT OF
Dodd-Frank

- Reported in October 2012
- Proposed mandatory separation of "significant":
  - Proprietary trading activities;
  - Market-making
  - Loans/ loan commitments/ unsecured exposures to hedge funds, private equity investments and structured investment vehicles (SIVs)
- These activities to be performed by a trading entity legally, operationally and economically separate from a deposit-taking bank

The EU – Liikanen: What Else Did He Propose?

THE CONTINUING IMPACT OF Dodd-Frank

- Amendments to bail-in proposals now being negotiated in the EU (Recovery and Resolution Directive)
- Changes to banks' capital requirements, particularly relating to trading assets and real estate related loans
- Reforms to banks' governance arrangements, including reforms to bankers' bonuses

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The EU – Liikanen: Where Are We Now?

THE CONTINUING IMPACT OF Dodd-Frank

- Concerns: a compelling case for mandatory separation had not been made; increased costs; damage to the competitiveness of the EU banking sector and inconsistency with Vickers and Volcker
- A proposal is expected be published in October 2013, but query content
- Call for detailed discussions before Commission given a mandate to draft legislation
- Could be influenced by another crisis or national developments, e.g., Vickers

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The EU: France

THE CONTINUING IMPACT OF Dodd-Frank

- Described as "ultra-light Volcker"
- Ring-fence to separate client-linked business from proprietary trading
- Proprietary trading can only be carried out by an autonomous and separately funded subsidiary with no access to insured deposits (i.e., "trading subsidiary")
- Aim: in force by mid-2015

The EU: Germany

THE CONTINUING IMPACT OF Dodd-Frank

- Proposal stage
- Due to be in force by mid-2015
- Ring-fences proprietary trading
- Both French and German regulators given power to define what amounts to proprietary trading
- Both proposals criticized for their limited impact

Questions?

THE CONTINUING IMPACT OF
Dodd-Frank

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Tab 5

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The Residential Mortgage Market: Current Trends and Expectations

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THE CONTINUING IMPACT OF
Dodd-Frank

Dodd-Frank Act Mortgage-Related Rules

THE CONTINUING IMPACT OF
Dodd-Frank

- Dodd-Frank Act's Title XIV provided CFPB with 18 months (January 21, 2013) to issue final rules and rules to be effective no later than 12 months after issuance
- Mortgage-related rules include:
  - Ability to repay/qualified mortgage (QM) standards
  - Mortgage originator standards
  - Mortgage servicing standards
  - High-cost mortgage loan requirements
  - Escrow accounts for certain mortgage loans
  - Appraisal disclosure and delivery requirements

Ability-to-Repay/QM Standards

- Final rule issued January 10, 2013 (effective January 10, 2014)
- Section 1411 of Dodd-Frank Act provides no creditor may make a residential mortgage loan without making reasonable and good faith determination that the borrower has the ability to repay the loan
- Two ways to satisfy ability-to-repay requirement
  - Lender makes a determination based upon the general ability to repay standards and guidance in rule
  - Lender makes a "qualified mortgage" or "QM"

Ability-to-Repay/QM Standards (cont.)

THE CONTINUING IMPACT OF
Dodd-Frank

- Damages for failure to comply include actual damages, statutory damages (up to $4,000 per violation) and enhanced damages (finance charges and fees paid)
- Three year statute of limitations for bringing lawsuit; but after three years borrower can still raise as defense in foreclosure or collection action by set off or recoupment
- Assignee liability: penalties for noncompliance can be asserted against lender, assignees and subsequent purchasers

Ability-to-Repay/QM Standards (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Ability-to-repay determination (at a minimum)
  - Current or reasonably expected income or assets
  - Current employment status (if relying on wage income)
  - Monthly payment on the mortgage loan
  - Monthly payment on any known simultaneous mortgage
  - Current debt obligations, alimony, child support
  - Monthly debt-to-income ratio or residual income
  - Credit history

Ability-to-Repay/QM Standards (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Rule creates three types of QMs: standard, temporary and balloon payment loans made by rural lenders
- Standard QM
  - Substantially equal and regular periodic payments; no negative amortization; no interest only payments
  - Term of 30 years or less
  - Points and fees do not exceed 3% of total loan amount
  - Verify income, assets and current debt obligations
  - Debt-to-income ratio does not exceed 43% (based upon FHA)

Ability-to-Repay/QM Standards (cont.)

- Temporary QM
  - Meets requirements for Standard QM except DTI > 43%
  - Still a QM if loan is eligible to be purchased, guaranteed or insured by Fannie, Freddie, HUD, VA, USDA or RHS
  - Requires loan be “eligible” for purchase, guarantee or insurance
    - Conforms to standards in Fannie/Freddie guides, or
    - “Approve/Eligible” from DU or “Accept/Eligible” from LP
  - Temporary QM exists for no longer than 7 years (1/10/21) but could terminate earlier if agencies (HUD, VA, USDA or RHS) issue own QM rule or Fannie/Freddie conservatorships end

Ability-to-Repay/QM Standards (cont.)

THE CONTINUING IMPACT OF
Dodd-Frank

- Safe harbor or rebuttable presumption that a “qualified mortgage” meets the ability-to-repay standard
- Safe harbor would effectively prevent borrower from subsequently challenging ability-to-repay determination
  - Safe harbor is “irrebuttable” presumption
  - Borrower could still challenge whether loan was QM

Ability-to-Repay/QM Standards (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Whether safe harbor or rebuttable presumption depends upon interest rate of mortgage loan
  - "Higher-priced" mortgage loans include a first-lien mortgage loan with an interest rate 1.5% over the average prime offer rate (APOR) [Freddie Mac's Primary Mortgage Market Survey] or a subordinate-lien mortgage loan with an interest rate 3.5% over APOR
  - For "higher-priced" mortgage loans, borrower may rebut presumption by showing that, at the time the loan was originated, the borrower's income and debt obligations left "<u>insufficient residual income or assets to meet living expenses</u>"
  - Rebuttable presumption would likely require court to analyze facts

Mortgage Servicing Rules

THE CONTINUING IMPACT OF Dodd-Frank

- Amend TILA/Reg Z and RESPA/Reg X (effective January 10, 2014)
- Rules include provisions from settlement among five largest servicers and state AGs (February 2012)
- Possible penalties for violations of rules
  - Statutory damages under TILA (up to $4000/violation)
  - Statutory damages under RESPA (up to $2000/violation)
  - Administrative enforcement by CFPB (or applicable bank regulatory agency) for all parts of rule

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Mortgage Servicing Rules (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Mortgage servicer requirements
  - Provide periodic billing statements to borrowers
  - Send interest-rate adjustment notices for ARMs
  - Promptly credit any payments and send payoff statements
  - Maintain clear procedures for error resolution

Mortgage Servicing Rules (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Mortgage servicer requirements (cont.)
  - Maintain procedures for information requests (QWR)
  - Prohibit charges for "force-placed insurance" absent reasonable belief borrower failed to maintain and notices provided
  - Establish information management policies and procedures
  - Develop early intervention procedures
  - Establish continuity of contact
  - Develop loss mitigation procedures

Mortgage Servicing Rules (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Early intervention with delinquent borrowers
  - Servicers must make early intervention attempts with delinquent borrowers, establishing live contact by 36th day of delinquency or good faith effort
    - Form of notice in rule (w/ loss mitigation and counselors)
    - Live contact does not include voicemail; may call, write or e-mail to arrange in person meeting
  - Servicers must provide written notification of loss mitigation options by 45th day of delinquency
    - Form of notice in rule
    - Only required once in 180-day period

Mortgage Servicing Rules (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Loss mitigation procedures
  - Exercise reasonable diligence to review loss mitigation application to determine whether complete
    - Acknowledge receipt within five days and indicate whether complete; if not, indicate specific information missing and deadline for submission
    - If 38 days or more before foreclosure sale, must evaluate within 30 days and provide determination to borrower
    - Any denial must include specific reasons, right to appeal and timeframe
  - Borrower's time to accept or reject any loss mitigation option
    - Seven days if loss mitigation application received less than 90 days before sale
    - 14 days if application received more than 90 days before sale

Mortgage Servicing Rules (cont.)

THE CONTINUING IMPACT OF
Dodd-Frank

- Loss mitigation procedures (cont.)
  - No "dual tracking"
  - No foreclosure filings until 120 days delinquent
    - Even if > 120 days delinquent, servicer may not start foreclosure unless borrower (1) not eligible for any loss mitigation option and no appeal (or appeal denied), (2) rejects loss mitigation offers or (3) fails to comply with terms of loss mitigation option
    - If application for loss mitigation submitted after foreclosure process started but > 37 days before scheduled foreclosure sale, servicer may not move for foreclosure until one of three conditions above satisfied
    - Application submitted during 120-day period or at least 90 days before foreclosure may be appealed to other personnel for at least 14 days
    - No further appeals permitted

Mortgage Servicing Rules (cont.)

THE CONTINUING IMPACT OF
Dodd-Frank

- Mortgage servicing transfers under RESPA
  - Subject to certain exceptions, notice of transfer of servicing must be provided to the borrower by transferor and transferee servicers
  - Model form included in RESPA/Reg X appendix
  - Not new requirement but new rule applies to all closed-end mortgage loans (not just first-lien loans)

Mortgage Servicing Transfers

THE CONTINUING IMPACT OF
Dodd-Frank

- On February 11, 2013, CFPB issued a bulletin (2013-01) regarding "Plans for Handling Servicing Transfer"
- CFPB may require servicers to submit written plans detailing how they will manage
- CFPB may request information regarding:
  - Number of loans, unpaid principal balance, name(s) of the servicing platform(s) and description of transaction; and
  - Customer-service plan specific to transferred loans that provides for responding to loss mitigation inquiries and identifying whether loan is subject to pending loss mitigation

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GSE Reform

THE CONTINUING IMPACT OF
Dodd-Frank

- GSE reform proposals
  - Treasury/HUD plan (February 2011)
  - FHFA strategic plan (February 2012)
- Corker-Warner GSE reform bill
  - Creation of Federal Mortgage Insurance Corporation
  - Guarantee fees
  - Eligible mortgages
  - Transition period
  - Conforming loan limit

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Acquisitions of Residential Mortgage Loans

- Federal and state regulatory considerations
  - State licensing laws
  - Assignee liability under state high-cost mortgage laws
  - Section 404 notices for transfers of ownership
  - Changing regulatory regime for originators and servicers

Acquisitions of Residential Mortgage Loans (cont.)

- Categories of assets
  - Nonperforming
  - Seasoned/reperforming
  - New origination jumbo

Acquisitions of Residential Mortgage Loans (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Categories of investors
  - REITs
  - Hedge funds
  - Insurance companies
  - Banks
  - Conduits
  - REO to Rental
  - Joint ventures

Acquisitions of Residential Mortgage Loans (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Servicing issues
  - Investors with dedicated servicers
  - Investors without servicers
    - Servicing retained
    - Aversion to foreclosure and ownership of REO

Private Label, New Origination Mortgage Securitization

THE CONTINUING IMPACT OF Dodd-Frank

- Status of private label, new origination mortgage securitization market
  - Significant growth, but still early
  - New entrants
- Impediments to more rapid growth
  - Rating agency uncertainty
  - Regulatory limbo
  - Ongoing legacy issues
  - Issuer or conduit model

Private Label, New Origination Mortgage Securitization

THE CONTINUING IMPACT OF Dodd-Frank

- Representation and warranty structure
  - Both providers and receivers unhappy with legacy transactions
  - For receivers
    - Meaningful enforcement mechanism
    - Skin in the game?
  - For providers
    - Assignment of reps?
    - Standard for definition of breach
    - Materiality/causation
    - Sunset provisions
    - Review mechanism

Questions?

THE CONTINUING IMPACT OF
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Tab 6

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Cross-Border and International Issues

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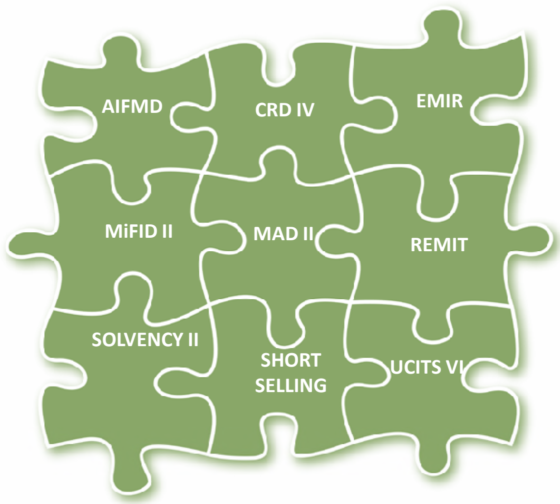
THE CONTINUING IMPACT OF
Dodd-Frank

Last Year's European Puzzle

THE CONTINUING IMPACT OF
Dodd-Frank



Update on European Regulatory Framework: National Regulation vs. Pan-European Regulation

- Pan-European supervision 1: European System of Financial Supervisors (ESFS) in place from January 1, 2011 including:
  - A political agreement to create a single financial services rule-book
  - The creation of the European Supervisory Authorities (ESAs) to enhance micro-prudential supervision mainly by national regulators
  - The creation of the European Systemic Risk Board (ESRB) to enhance macro-prudential supervision by national authorities

Update on European Regulatory Framework: Latest Developments

- Pan-European supervision 2: banking union
  - Single supervisor (ECB) for banks in the Eurozone
  - Proposals for a single resolution mechanism for banks in the Eurozone expected imminently

<u>BUT</u>

- Beginning of a multi-speed EU: Eurozone vs. Euro-outs?
- National interests starting to be given greater prominence again?
  - UK defended position of Euro-outs in banking union
  - UK challenge to the short-selling regulation
  - UK challenge to the financial transaction tax (FTT)

The Financial Transaction Tax: The Basics

THE CONTINUING IMPACT OF Dodd-Frank

- Return to national differences? Only being adopted by a sub-set of the EU
- Original aim: national implementation by September 30, 2013, and FTT to come into effect on January 1, 2014, but timetable now extremely unlikely
- Sets minimum levels of taxation:
  - 0.01% on derivatives
  - 0.1% on all other financial instruments (shares, bonds, etc)

Financial Transaction Tax: UK Legal Challenge

THE CONTINUING IMPACT OF Dodd-Frank

- Measure adopted by a subset of the EU must not:
  - Undermine the internal market or economic, social and territorial cohesion
  - Constitute a barrier to or discrimination in trade between EU countries
  - Distort competition between them
- Such a measure must also respect the competence, rights and obligations of those EU countries that do not participate in it
- Associated expenditure shall be borne by the participating countries

The Financial Transaction Tax: Who Pays?

THE CONTINUING IMPACT OF Dodd-Frank

- The FTT will be payable if:
  - Any party to a financial transaction is "established" in the FTT-zone and a financial institution is party to the transaction (acting as principal or agent), irrespective of where the transaction takes place (the "residence principle"); or
  - If a financial instrument issued in the FTT-zone is traded anywhere and a financial institution is party to the transaction (acting as principal or agent), even if no party to the transaction is established within the FTT-zone (the "issuance principle")

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The Financial Transaction Tax: Where Are We Now?

THE CONTINUING IMPACT OF Dodd-Frank

- Little will happen before the German elections in September 2013; indications that the proposal will be narrowed
- Possible that FTT will:
  - Be restricted to issuance principle
  - Be staggered so introduced initially re shares, then perhaps derivatives and then perhaps bonds
  - All rates reduced to 0.01%
- No certainties

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Increasing Examples of Extraterritorial Reach: EMIR (EU Regulation of OTC Derivatives)

- Clearing obligation applies to contracts entered into by a counterparty in the EU and a third country entity ("T") provided that T would be subject to the clearing obligation if it were established in the EU
- Clearing obligation and the risk mitigation requirements apply to contracts between Ts that would be subject to the clearing obligation if they were established in the EU, provided that the contract has a "direct, substantial and foreseeable effect within the" EU "or where such an obligation is necessary or appropriate to prevent the evasion of any provisions of" EMIR

Increasing Examples of Extraterritorial Reach

- Third country central counterparties (CCPs) can only provide clearing services to its clearing members which are established in the EU where that CCP is recognized by the European Securities and Markets Authority (ESMA)
- A similar approach to third country trading venues is expected
- A trading obligation mirrored on the clearing obligation is also expected
- Important to determine what "direct, substantial and foreseeable effect" means and to make "equivalence" decisions (i.e., decisions which deem a third country regime equivalent to that of the EU)

Extraterritorial Application of the US Securities Laws

THE CONTINUING IMPACT OF Dodd-Frank

- *Morrison v. National Australia Bank* (2010)
  - F-cubed
  - Conduct and effects test overruled
  - Presumption against extra-territoriality applied
  - *Amicus* briefs cited
  - New rule: Section 10(b) does not extend beyond "transactions listed on domestic exchanges, and domestic transactions in other securities."

Extraterritorial Application of the US Securities Laws (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- *Viking Global Equities v. Porsche* (Second Circuit 2011)
  - Plaintiffs were hedge funds that lost money in VW "short squeeze"
    - Plaintiffs purchased derivatives that referenced VW shares
  - Sued Porsche under Exchange Act Section 10(b) in federal court
  - Interpretation of *Morrison*
    - Plaintiffs: transactions confirmed in US
    - Trial court: "economic reality"
  - Second Circuit appeal pending
    - *Amicus* brief: "Domestic transaction plus" test

Extraterritorial Application of the US Securities Laws (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- *Viking Global Equities v. Porsche* (N.Y. Ct. App. 2013)
  - Same plaintiffs brought state common law claims against Porsche while Second Circuit case was pending
  - No class allegations, so the Securities Litigation Uniform Standards Act (SLUSA) not applicable
  - Porsche obtained dismissal on *forum non conveniens* grounds
  - New York appellate division affirmed
  - Prevented end run around *Morrison*

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Extraterritorial Application of the US Securities Laws (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- *In re UBS Securities Litigation* (Second Circuit 2013)
  - UBS global registered shares traded on NYSE and Swiss SIX exchange
    - Plaintiffs bought UBS shares in Swiss SIX exchange
  - Interpretation of *Morrison*
    - Plaintiffs: "Listing Theory"
    - Defendants: *Morrison* prohibits because shares were traded abroad
    - Trial court dismissed
  - Now before the Second Circuit
    - *Amicus* brief filed

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Extraterritorial Application of the Alien Tort Claims Act (ATCA)

THE CONTINUING IMPACT OF Dodd-Frank

- Many banks have been sued under the ATCA, but none have been held liable
  - Generally based on allegations that banks engaged in routine banking transactions with primary governmental bad actors
- *Kiobel v. Royal Dutsche Petroleum* (2013)
  - Applied presumption against extraterritoriality
  - ATCA applies only to domestic conduct
  - *Amicus* briefs (governments, trade associations)

Extraterritorial Application of Other Aspects of Dodd-Frank?

THE CONTINUING IMPACT OF Dodd-Frank

- Supreme Court's principle could apply to any extraterritorial regulations that are not supported by clear congressional intent to reach non-US conduct
  - *Asadi v. G.E. Energy (USA), LLC* (S.D. Tex. 2012). Dodd-Frank anti-retaliation protection provision for whistleblowers does not apply extra-territorially
  - Application in other contexts possible

Extraterritorial Judgment Enforcement

THE CONTINUING IMPACT OF Dodd-Frank

- *Koehler v. Bank of Bermuda*
  - The “separate entity rule”
  - Ordered to bring stock certificates from Bermuda to New York to pay judgment debtor

Extraterritorial Judgment Enforcement (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Interpretation of *Koehler* in federal court
  - Broad interpretation, applies to deposited assets globally
    - *JW Oilfield Equipment, LLC v. Commerzbank* (S.D. N.Y. 2011)
  - Narrow interpretation, “separate entity rule” still the law
    - *Shaheen Sports, Inc. v. Asia Ins. Co.* (S.D. N.Y. 2012)
- Interpretation of *Koehler* in state court
  - Narrow interpretation, “separate entity rule” still applies
    - Separate entity rule is judge-made
    - Burden on commerce
    - Comity

Extraterritorial Judgment Enforcement (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- *Commonwealth of the Northern Marianas Islands v. Canadian Imperial Bank of Commerce*
  - S.D. N.Y.: CIBC could not be compelled to turnover assets from its Barbados subsidiary
    - Test is "possession" or "custody"
  - Second Circuit certified questions to the N.Y. Court of Appeals
    - *Amicus* brief: New York turnover law does not apply to bank accounts because they are not personal property
    - Second Circuit certified questions: Does New York turnover law extend to affiliates? If so, when?

Extraterritorial Judgment Enforcement (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- *Commonwealth of the Northern Marianas Islands v. Canadian Imperial Bank of Commerce* (cont.)
  - N.Y. Court of Appeals (2013)
    - Turnover applies only if the bank has "actual, not merely constructive, possession or custody" over assets sought by a judgment creditor.
  - *Amicus* argument still unresolved

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Tab 7

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Recent Developments in Securitization

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THE CONTINUING IMPACT OF
Dodd-Frank

SEC's Money Market Fund Proposal (Rule 2a-7 Changes)

THE CONTINUING IMPACT OF
Dodd-Frank

- Most important changes for asset-backed securities
  - Valuation and pricing
  - Diversification
- Proposals to change valuation and pricing of money market funds
  - Floating net asset value
  - Fees and gates

SEC's Money Market Fund Proposal (Rule 2a-7 Changes) (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Proposals to change diversification requirements
  - Aggregation of affiliates
    - Request for comment on inclusion of consolidated entities
    - Limited to 10% of fund's assets
  - Aggregation of ABS issuers with sponsors unless fund's has determined (and maintains a written record) that fund is not relying on:
    - Sponsor's financial strength
    - Sponsor's ability or willingness to provide:
      - Liquidity
      - Credit support
      - Other support
    - Limited to 10% of fund's assets

SEC's Money Market Fund Proposal (Rule 2a-7 Changes) (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Proposals to change diversification requirements (cont.)
  - Reasons:
    - Intended to apply to structured investment vehicles (SIVs) and asset-backed commercial paper (ABCP)
    - Does this make sense for repacks or deals with no risk retention?

Clearing of SPE Swaps

THE CONTINUING IMPACT OF Dodd-Frank

- Mandatory clearing – standardized and uniform swaps
  - "Securitization" swaps?
  - Have we increased the likelihood that a bankruptcy of a major swap participant will take down the entire system (compare to 1987 crash)
- Trading – if it must be cleared, it must be "traded," if a facility makes it available
- Margin requirements currently apply cleared swaps
- Discuss current status of clearing for SPE swaps

Rating Agency Reform

THE CONTINUING IMPACT OF Dodd-Frank

- SEC Rule 17g-5
- SEC Rule 17g-7
- Greater regulation of rating agency conflicts
  - Separation of business and rating sides of agency
  - Requirements to have policies and disclosure of exceptions to policies
- Dodd-Frank Act
  - Elimination of references to ratings in federal rules
  - "Franken Amendment"
    - SEC study basically kicked the can down the road without making any important recommendations.
    - SEC has called for an April roundtable to further discuss

Accounting

THE CONTINUING IMPACT OF Dodd-Frank

- Suddenly banks and others are more interested in off-balance sheet (B/S) deals
  - More off-B/S deals will be done in 2013
- Accounting changes
  - FAS 166 and 167 in US
  - IFRS 9 and 10 outside US
  - Sale treatment became harder for international financial reporting standards (IFRS) but potentially easier under US generally accepted accounting principles (GAAP)
  - Avoiding consolidation became harder under both US GAAP and IFRS

Regulation of Commodity Pool Operators

THE CONTINUING IMPACT OF Dodd-Frank

- Dodd-Frank added new terms to Commodity Exchange Act:
  - "Commodity Pool" and "Commodity Pool Operator" (CPO)
  - Inclusion of "swaps" as commodity interests
- NOT just prospective – legacy entities are also affected
- CFTC broadly interprets "trading"
  - A single swap used for hedging may be sufficient to constitute "trading"
- Any CPO or commodity trading adviser (CTA), unless exempt, is required to register and meet related requirements
  - CPO/CTA registration is burdensome and imposes regulatory requirements that will be difficult for securitization issuers to satisfy

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Regulation of Commodity Pool Operators (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Consequences if violated:
  - Willful violation is a felony punishable by a fine of up to $1M or imprisonment for up to 10 years or both
  - Private action/damages against a person who violates the CEA or who willfully aids, abets, counsels, induces or procures a violation
  - Non-exempt unregistered CPOs do not qualify as “eligible swap participants”
  - Commodity pools are “covered funds” under proposed Volcker Rule, and can’t be owned or sponsored by banks and their affiliates

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CFTC Interpretation Letters 12-14 and 12-45

THE CONTINUING IMPACT OF Dodd-Frank

- CFTC safe harbors that an ABS issuer would not be a “commodity pool” if:
  - Activities limited to passively owning or holding a pool of receivables or other financial assets that by their terms convert to cash within a finite period, plus any rights or other assets designed to assure the servicing or timely distributions of proceeds to security holders
  - Use of derivatives limited to those permitted by Regulation AB (i.e., interest rate and currency swaps)
  - Swaps are not used to create an investment exposure
    - I.e., return on security is not variable based variability of payment requirements under the swaps
  - Explicit recognition that ABCP conduits, traditional CDOs and covered bond issuers are examples of such entities

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CFTC Interpretation Letters 12-14 and 12-45 (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- No-action relief until March 31, 2013, for failure to register as a CPO if:
  - Securities issued before October 12, 2012, backed by payments of cash or synthetic assets owned by the issuer
  - No new securities on or after October 12, 2012
  - Issuer promptly (within five business days after request) provides to CFTC certain reporting information
- Will March 31, 2013 date be extended?
- No relief provided for synthetic securitizations

CFPB Crackdown on Dealer Markups

THE CONTINUING IMPACT OF Dodd-Frank

- CFPB wants to eliminate dealer "markups"
  - Dealers get paid more if they get a higher interest rate from the obligor
  - Perception that consumers are unfairly required to pay higher rates
- CFPB announced in March 2013 intention to prosecute indirect lenders for markups
- Risk of class action lawsuits seeking to lower the interest rates charged to obligors, including those in ABS pools
- Expect some disclosure of markups and CFPB position in prospectuses and offering memos

Reg AB II and Shelf Availability

THE CONTINUING IMPACT OF Dodd-Frank

- Process and timing for Reg AB II
  - Pre-Dodd-Frank original Reg AB II release
  - Dodd-Frank addressed several of the topics covered in the original Reg AB II release
  - Subsequent release issued on July 26, 2011, with additional SEC questions and proposals. Comment period ended more than 15 months ago
  - Could come out any time
  - Expect a one-year transition period after final rules are issued – new Rules probably won't apply until some time in 2014
  - SEC has had significant turnover, which could delay all rules

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Reg AB II and Shelf Availability (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Holdup is privacy issues on loan-level data, which would be required both in prospectus and ongoing reports
- Some other important Reg AB II proposals
  - Public-style disclosure for private offerings
  - Changes to eligibility requirements for shelf registration
    - Replacement of investment grade rating requirement with Executive Officer Certification
    - Five business day waiting period prior to pricing/sale of securities
  - "Pay as you go" registration fees

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Risk Retention

THE CONTINUING IMPACT OF Dodd-Frank

- Dodd-Frank created a new Section 15G of Exchange Act
- Purposes:
  - Align ABS sponsor incentives with investors
  - Require sponsors to have "skin in the game"
- Generally requires the sponsor of an asset backed security to retain a 5% economic interest in the credit risk of the securitized assets
  - Applies to both registered and unregistered deals
- Compliance dates:
  - RMBS: One year after final rules
  - Everything else: Two years after final rules
- Timing: Now that QM Rules are out, could be any time

Basic Forms of Risk Retention

THE CONTINUING IMPACT OF Dodd-Frank

- Vertical slice
- Eligible horizontal residual interest
- Horizontal reserve account option
- "L-shaped" risk retention
- Representative sample
- Seller's interest in master trust

Some Important Risk Retention Issues

THE CONTINUING IMPACT OF Dodd-Frank

- Qualified residential mortgages would be excluded
  - Cannot be broader than new CFPB definition of "Qualified Mortgage"
- Premium capture cash reserve account
- Restrictions on hedging, pledging, transfers
- Exceptions for ABCP conduits doesn't work and would require disclosure of ABCP customers
- Exception for qualified auto loans
  - No previous deals (and probably no previous loans) qualify
  - Would not allow securitization of a cross section of portfolio

Conflicts of Interest

THE CONTINUING IMPACT OF Dodd-Frank

- D-F Section 621 prohibits "material conflicts of interest" with ABS investors for year after closing
  - Both public and private deals
- SEC rule was broad and vague, with only very narrow exceptions
  - But release made clear that only short transactions were intended to be prohibited
- Synthetic securitizations might be completely prohibited
- Final rules could be adopted at any time

Volcker Rule

THE CONTINUING IMPACT OF Dodd-Frank

- Proposed Volcker Rule prohibits a "banking entity" (very broadly defined) and its affiliates (including foreign entities, unless no contact with US) from:
  - "Proprietary trading" in securities, derivatives and other instruments
  - Sponsoring or investing in "covered funds," which include private equity and hedge funds but also some securitization entities
  - "Super 23A" provision prohibits certain transactions with covered funds for which banking entities serve as investment adviser/manager/sponsor
- Covered fund provisions do not apply to securitizations which don't exclusively rely on the 3(c)(1) or 3(c)(7) exemptions from Investment Company Act
- Volcker exemptions were intended to permit securitizations, but needed work
  - Will the regulators do the necessary work to get this right?
- FRB policy statement requires banks today to develop/implement conformance plans that are as specific as possible on how the firms will conform their activities by 2014

Other Recent Developments

THE CONTINUING IMPACT OF Dodd-Frank

- SEC Rule 193/Item 1111(a)(7)
  - Issuers in registered public ABS deals must perform a review of the pool assets and disclose in prospectus
  - Go through Item 1111 information line-by-line to determine the procedures that provide reasonable assurance of accuracy in all material respects
- Disclosure of underwriting deviations (Item 1111(a)(8))
  - Disclosure of deviations from disclosed underwriting criteria or benchmarks

Other Recent Developments (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Repurchases (Rule 15Ga-1)
  - Requires *securitizers* (sponsors and depositors) to file quarterly Form ABS-15G to disclose information about repurchase demand activity
  - Applies to all outstanding "asset-backed securities," registered and unregistered which contain a *covenant to repurchase or replace* assets for breach of representations or warranties
  - Securitizers with no repurchase activity can check the "no activity" box on the first report and thereafter report annually
- EU Capital Requirements Directive Article 122a
  - Risk retention: Credit institution investors must obtain confirmation that originator, sponsor or original lender has retained 5% net economic interest. (Retention can be vertical, first loss, originator interest or similar exposures)
  - Due diligence requirement: Comprehensive understanding of transaction and risk, including stress testing

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Overview

THE CONTINUING IMPACT OF Dodd-Frank

- Business conditions have improved
  - Housing prices have stabilized
  - GSE reforms taking root
  - Tiering of originators and servicers
- Regulatory reforms are falling into place
  - QM – Ability-to-repay
  - Basel III
  - QRM – Dodd-Frank risk retention

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QM – Ability-to-Repay

Ability to Repay/QM Standards

- Standard QM
  - Substantially equal and regular periodic payments
  - No negative amortization
  - No interest only payments
  - Term of 30 years or less
  - Points and fees do not exceed 3% of total loan amount
    - Includes finance charges, broker compensation, upfront credit insurance charges, real estate related fees paid to affiliates
    - Excludes interest, up to 2 *bona fide* discount points, PMI
    - Higher fees permitted for smaller loans (< $100,000)
  - Verify income, assets and current debt obligations
  - Debt-to-income ratio does not exceed 43% (based upon FHA)

Ability to Repay/QM Standards (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Significance of QM
  - Presumption that borrower has ability to repay
  - Important to assignees and subsequent purchasers
  - Advantages for HELOCS?
- Impact on loan pricing and risk management
  - Safe harbor (1^{st} APOR < 1.5%) / (2^{nd} APOR < 3.5%)
  - Rebuttable presumption (1^{st} APOR ≥ 1.5%) / (2^{nd} APOR ≥ 3.5%)
  - High-cost mortgage (1^{st} APOR ≥ 6.5%) / (2^{nd} APOR ≥ 8.5%)

Regulatory Reforms

THE CONTINUING IMPACT OF Dodd-Frank

Basel III

Mortgage Loans under Basel I

THE CONTINUING IMPACT OF
Dodd-Frank

Existing Basel I treatment

- 50% risk weight if:
  - First lien, prudently underwritten
  - Owner-occupied
  - Not 90 days past due
  - Otherwise 100%

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Mortgage Loans under Basel III

THE CONTINUING IMPACT OF
Dodd-Frank

- Basel III provides much more complicated rules that depend on a number of factors
- US Standardized NPR for Basel III

LTV	Category 1	Category 2
≤ 60%	35%	100%
> 60% & ≤ 80%	50%	100%
> 80% & ≤ 90%	75%	150%
> 90%	100%	200%

  - 50% or less (35%) only for traditional firsts meeting very conservative underwriting AND LTVs of 80% or less (w/o PMI)
    - 75-200% for others

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Categories 1 and 2 under Basel III

Category 1

- Term not greater than 30 years
- Fully amortizing, regular periodic payments (i.e., no negative amortization, balloons)
- Prudent underwriting, including all of borrower's obligations (taxes, insurance) AND ability to repay (using maximum interest rate during first 5 years)
- Interest rate caps: 2%/year; 6% life of loan
- Can't be 90 days or more past due
- No junior liens

Category 2

- Everything else (including both liens held by same institution if one of them is Category 2)
  - RW at least 2X Category 1 with 100% minimum

Other Implications of Basel III

- LTV calculation guidelines
  - Value based on lower of purchase price or estimated value (based on appraisal or other regulatory-permissible measure)
  - Loan amount
    - Firsts: unpaid principal (including maximum contractual of junior if hold both)
    - Junior: maximum contractual amount PLUS all senior liens
  - Measured at origination or modification

Other Implications of Basel III (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Modifications
  - Current Basel I precludes 50% RW (i.e., 100%)
  - NPR: no automatic rule; reassess modified loan using new criteria (Category 1 v. 2; LTV)
    - But must update appraisal if want to get RW below 100% for Category 1 or 200% for Category 2
    - Language of NPR suggests no impact for prior 90+ day delinquencies, but this is not certain
  - HAMP modifications excluded (i.e., no effect)

Other Implications of Basel III (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Treatment of mortgage servicing rights (MSRs)
  - Current Basel I/II: no deduction; risk-weighted at 100%; 10% FMV haircut; applies to purchased MSRs only
  - Basel III Numerator NPR: deduct excess over 10% of CET1 (note it's common equity tier 1, a new tighter standard than Tier 1); 250% (rather than 100%) risk weight for included amount; AND the 10% FMV haircut; applies to purchased and originated/ retained MSRs
    - Also deduct if aggregate of MSRs, deferred tax assets and investments in other financial institutions exceeds 15% of CET1
  - Result can easily be 2-3x more capital against MSRs under NPR
  - Huge disincentive to retain servicing when loans sold

Impact of Basel III

THE CONTINUING IMPACT OF Dodd-Frank

- Exclusion of all IO and balloon mortgages from Category 1
- Unfavorable treatment of popular ARMs (e.g., non-teaser rate 1-year ARMs)
  - Borrowers must qualify based on maximum interest rate
  - Issues raised with 5/2/5 ARMs
- Cliff effects of only 4 LTV categories
- **Capital required against loans sold subject to "credit enhancing reps and warranties" (e.g., early payment default repurchase obligations)**
- Unfavorable treatment of MSRs

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Regulatory Reforms

THE CONTINUING IMPACT OF Dodd-Frank

QRM – Dodd-Frank Risk Retention

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Risk Retention Overview

THE CONTINUING IMPACT OF Dodd-Frank

- General definitions and scope
  - Dodd-Frank created a new Section 15G of Exchange Act to align incentives with investors and require originators to have "skin in the game"
  - Generally requires the sponsor of an asset backed security to retain a 5% economic interest in the credit risk of the securitized assets
    - Registered and unregistered deals
    - Do you have a "security," "asset backed security "or "sponsor"
    - Sponsor may not transfer or hedge the retained interest
  - Compliance dates: RMBS: One year after final rules. Everything else: two years after final rules

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Risk Retention Overview (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Basic forms of risk retention
  - Vertical slice
  - Eligible horizontal residual interest
    - Requires allocation of losses; three waterfalls
    - Is "par value" the same as FMV?
  - Horizontal reserve account option
  - "L-shaped" risk retention
  - Representative sample
  - Seller's interest in warehouse facility

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QRM and Special Problems for Mortgages

THE CONTINUING IMPACT OF
Dodd-Frank

- The RMBS basics
  - Unless an exemption applies, residential mortgage securitization transactions are subject to 5% retention requirement and all other risk retention rules
  - For RMBS, it's all about the exemptions
    - Qualified Residential Mortgage (QRM) loan exemption, which can be no broader than the QM Safe harbor
    - GSE (Fannie Mae and Freddie Mac) exemptions

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QRM and Special Problems for Mortgages (cont.)

THE CONTINUING IMPACT OF
Dodd-Frank

- The QRM exemption
  - Focused on key factors in mortgage meltdown
    - Absence of down payments (now 20% – 30%) required
    - Exotic mortgage products (e.g., pay option arms)
    - Bad appraisals
    - Shaky borrower balance sheets
    - Servicers refusing loan modifications
  - ARMs permitted, subject to lifetime (8%) cap on increase in rate
  - This "lowest common denominator" approach eliminates significant parts of the mortgage market

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Special Problems for Mortgages

THE CONTINUING IMPACT OF Dodd-Frank

- Special problems
  - Premium recapture provisions for non-exempt (non-QRM) mortgage loans
    - Creates additional subordination not included in risk retention levels
    - Prevents rate locks because premium loans could be created
    - Radically changes upfront economics
  - QRM servicing standards
    - Putting this in mortgage documents creates new causes of action or defenses for borrowers
    - Potential problem if servicing standards change down the road
    - Not a simpler plain english mortgage document for obligors
    - Possibly exceeds D-F authority
    - Would CFPB enforce these obligations?
    - May disappear after release of CFPB servicing standards
  - Mortgage insurance is disregarded – competitive advantage to GSEs
  - 28% debt-to-income ratio is restrictive

Likely Market Opportunities from Regulatory Changes

THE CONTINUING IMPACT OF Dodd-Frank

- Banks will simplify their loan product offerings:
  - Conforming loans to be sold to GSEs
  - Non-conforming loans that satisfy the following:
    - QM safe harbor
    - Favorable Basel III risk weights
    - QRM

Likely Market Opportunities from Regulatory Changes (cont.)

- Non-banks (REITs and finance companies) will provide credit to the rest of the mortgage market
  - These sources of capital are currently participants in the financing of non-performing mortgage loans
  - These sources of capital are also purchasing mortgage servicing rights from capital sensitive bank owners
  - Availability of bank leverage (repo market and securitization markets) is critical because these sources of capital do not have access to deposits and government funding

Other Rules

Other Dodd-Frank Rules

Other Rules – 15Ga-1

THE CONTINUING IMPACT OF Dodd-Frank

- Requires *securitizers* (sponsors and depositors) to file quarterly Form ABS-15G to disclose information about repurchase demand activity
- Applies to all outstanding "asset-backed securities" (as defined in Section 3(a)(77) of the Exchange Act)
  - Includes registered **and unregistered** deals
  - Applies to deals in which transaction documents contain a *covenant to repurchase or replace* assets for breach of representations or warranties
- Quarterly filings to be submitted 45 days after the close of each calendar quarter

Other Rules – Rule 193

THE CONTINUING IMPACT OF Dodd-Frank

- New Rule 193 requires that issuers in registered public ABS deals perform a review of the pool assets underlying the asset-backed security
- Review requires the following steps:
  - Identify the Item 1111 information in prospectus
  - Go through that information line-by-line to determine the procedures that provide reasonable assurance of accuracy in all material respects
  - Disclosure in prospectus

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Other Rules - Rating Agency Reform

- SEC Rule 17g-5
  - Requires posting of rating agency materials to a protected website
  - Possible solution for the Franken Amendment?
- SEC Rule 17g-7
  - Requires rating agency reports to summarize representations and warranties and enforcement mechanisms
  - Generally satisfied by disclosures versus representations and warranty benchmarks

Historical Background

- Basel I risk-based capital framework
  - Issued by Basel Committee in 1988 and adopted in the United States in 1989
  - Capital requirements account for credit risk for first time
  - Modified in 2002 to add recourse rules and ratings-based approach for ABS
- Market risk rule
  - Issued by Basel Committee and adopted in the United States in 1996
  - Add-on to the Basel I (and later Basel II) risk-based capital requirements to cover "trading book" exposures
  - Applies to US banks/BHCs with trading activity that exceeds 10% of total assets or $1 billion

Historical Background (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Basel II
  - Issued internationally by Basel Committee in 2004
  - Not adopted in the United States until late 2007, and then only the advanced approaches for largest US "core banks"
    - $250 billion in total assets or $10 billion in foreign exposure
    - Long qualification period; no US bank currently actually operating under Basel II
- US regulators proposed Basel I modifications (December 2006) and Basel II standardized approach for non-core banks (July 2008), but neither proposal was implemented
- Progress on US Basel II implementation slows due to financial crisis

Basel III (Proposed Rule)

THE CONTINUING IMPACT OF Dodd-Frank

- May 2012: Basel Committee proposes revised market risk framework based on "fundamental review" of trading book capital requirements
  - More "objective" boundary between banking and trading book to prevent arbitrage
  - More restrictive approval processes and constraints for internal models, including a mandatory "fall-back" standardized approach for banks using models
  - US regulators have signaled intent to follow suit
- June 2012 (published August 30, 2012): US regulators (1) adopt final rule implementing Basel 2.5 revisions and Dodd-Frank 939A compliance to the Market Risk Rule, and (2) issue 3 separate proposals:
  - NPR 1 – Basel III Minimum Capital Requirements, Definition of Capital and Capital Buffers ("Basel III NPR")
  - NPR 2 – Standardized Approach for Risk-Weighted Assets ("Standardized Approach NPR")
  - NPR 3 – Advanced Approaches and Market Risk ("Advanced Approaches NPR")
- July 2012: BCBS amendments to Basel II/III for exposures to central counterparties
- October 2012: BCBS D-SIB final framework with lots of national discretion
- December 2012: BCBS consultative document: revisions to the securitization framework

Basel III Proposal

THE CONTINUING IMPACT OF Dodd-Frank

- Components of capital:
  - Tier 1 capital – common equity tier 1 capital and additional tier 1 capital
  - Total tier 1 capital, plus tier 2 capital, would constitute total risk-based capital
- Proposed criteria for common equity and additional tier 1 capital instruments, and tier 2 capital instruments, are broadly consistent with the Basel III criteria

Basel III Proposal (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Common equity tier 1 capital elements:
  - Common stock and related surplus net of treasury stock satisfying 13 criteria
  - Retained earnings
  - Accumulated other comprehensive income (AOCI)
  - Qualifying common equity tier 1 minority interest
- Common equity tier 1 criteria are generally designed to assure that the capital is perpetual and is unconditionally available to absorb first losses on a going-concern basis, especially in times of financial stress.

Basel III Proposal (cont.)

- Additional tier 1 capital elements:
  - Qualifying capital instruments (and related surplus) that satisfy 13 separate criteria (14 for advanced approaches banking organizations)
  - Tier 1 minority interests that are not included in a banking organization's common equity tier 1 capital
  - Qualifying TARP and Small Business Jobs Act preferred securities that previously were included in tier 1 capital
- The 13/14 criteria generally are designed to assure that the capital instrument can absorb going-concern losses and does not possess credit sensitive or other terms that would impair its availability in times of financial stress

Basel III Proposal (cont.)

THE CONTINUING IMPACT OF
Dodd-Frank

- Tier 2 capital elements:
  - Qualifying instruments that satisfy 10 separate criteria (11 for advanced approaches banking organizations)
  - Qualifying total capital minority interest not included in tier 1 capital
  - Allowance for loan and lease losses (ALLL) up to 1.25% of standardized total risk-weighted assets excluding ALLL (advanced approaches bank may include excess of eligible credit reserves over total expected credit losses not to exceed 0.6 percent of its total credit RWA)
  - Qualifying TARP and Small Business Jobs Act preferred securities that previously were included in tier 2 capital
- Tier 2 capital elements are designed to assure adequate subordination and stability of availability

Basel III Proposal (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Significant exclusions from tier 1 capital
  - Non-cumulative perpetual preferred stock, which presently qualifies as simple tier 1 capital, would not qualify as common equity tier 1 capital, but would qualify as additional tier 1 capital
  - Cumulative preferred stock would no longer qualify as Tier 1 capital of any kind
  - Certain hybrid capital instruments, including trust preferred securities, no longer will qualify as tier 1 capital of any kind
- Some of these results are mandated more by the Dodd-Frank Act (section 171, or the "Collins Amendment") than by Basel III itself

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Basel III Proposal (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Regulatory capital adjustments – common equity tier 1:
  - Accumulated net gains/losses on specified cash flow hedges included in AOCI
  - Unrealized gains and losses on AFS securities
    - Unrealized gains on AFS securities includable in Tier 2 would be eliminated
  - Unrealized gains and losses resulting from changes in banking organization creditworthiness

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Basel III Proposal (cont.)

- Deductions from tier 1 common equity capital:
  - Goodwill, net of associated deferred tax liabilities (DTLs)
  - Intangible assets other than mortgage servicing assets ("MSAs"), net of associated DTLs
  - Deferred tax assets
  - Securitization gain-on-sale
  - Defined benefit plan assets (excluding those of depository institutions (DIs))
  - Advanced approaches banks: expected credit losses exceeding eligible credit reserves
  - Savings association impermissible activities
  - Items subject to 10%/15% common equity tier 1 capital thresholds (certain DTAs, MSAs, significant unconsolidated FI common stock investments)

Basel III Proposal (cont.)

THE CONTINUING IMPACT OF
Dodd-Frank

- Deductions from tier1/tier2 capital:
  - Direct and indirect investments in own capital instruments
  - Reciprocal cross-holdings in financial institution capital instruments
  - Direct, indirect and synthetic investments in unconsolidated financial institutions. Three basic types:
    - Significant tier 1 common stock investments
    - Significant non-common-stock tier 1 investments
    - Non-significant investments (aggregate 10% ceiling)
  - The "corresponding deduction" approach
  - Volcker Rule covered fund investments (from tier 1)(when Volcker Rule regulatory capital requirements are final)
  - Insurance underwriting subsidiaries

Basel III Proposal (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Minority Interests:
  - Limits on type and amount of qualifying minority interests that can be included in tier 1 capital
  - Minority interests would be classified as a common equity tier 1, additional tier 1, or total capital minority interest depending on the underlying capital instrument and on the type of subsidiary issuing such instrument
  - Qualifying common equity tier 1 minority interests are limited to a DI or foreign bank that is a consolidated subsidiary of a banking organization
  - Limits on the amount of includable minority interest would be based on a computation generally based on the amount and distribution of capital of the consolidated subsidiary

Basel III Proposal (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Minimum capital requirements (fully phased-in):
  - Common equity tier 1 capital ratio to standardized total risk-weighted assets (TRWA) of 4.5%
  - Tier 1 capital ratio to standardized TRWA of 6%
  - Total capital ratio to standardized TRWA of 8%
  - Tier 1 leverage ratio to average consolidated assets of 4%
  - Advanced approach banking organizations must use lower of standardized TRWA or advanced approaches TRWA
  - For advanced approaches banking organizations, a supplemental leverage ratio of tier 1 capital to total leverage exposure of 3%
- Common equity tier 1 capital ratio is a new minimum requirement

Basel III Proposal (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Leverage Requirement:
  - Measured as a ratio of tier 1 capital (minus required deductions) to average on-balance sheet assets for all US banking organizations
- Supplementary leverage requirement:
  - Applies only to advanced approaches banking organizations
  - Ratio of tier 1 capital (minus required deductions) to average on-balance sheet assets, plus certain off-balance sheet assets and exposures:
    - Future exposure amounts arising under certain derivatives contracts
    - 10% of notional amount of unconditionally cancelable commitments
    - Notional amount of most other off-balance sheet exposures (excluding securities lending and borrowing, reverse repurchase agreement transactions, and unconditionally cancelable commitments)

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Basel III Proposal (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Capital conservation buffer:
  - A new phased-in capital conservation buffer for all banking organizations equal to a ratio to TRWA of 2.5% common equity tier 1 capital
  - Unrestricted payouts of capital distributions and discretionary bonus payments to executives and their functional equivalents would require full satisfaction of capital conservation buffer requirement
  - Maximum amount of restricted payouts would be the banking organization's eligible retained income times a specified payout ratio. These ratios would be established as a function of the amount of the banking organization's capital conservation buffer capital

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Basel III Proposal (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Countercyclical capital buffer:
  - A macro-economic countercyclical capital buffer of up to 2.5% of common equity tier 1 capital to TRWA applicable *only* to advanced approaches banking organizations
  - Countercyclical capital buffer, applied upon a joint determination by federal banking agencies, would augment the capital conservation buffer
  - Unrestricted payouts of capital and discretionary bonuses would require full satisfaction of countercyclical capital buffer as well as capital conservation buffer

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Basel III Proposal (cont.)

THE CONTINUING IMPACT OF Dodd-Frank

- Supervisory assessment of capital adequacy
  - Banking organizations must maintain capital “commensurate with the level and nature of all risks” to which the banking organization is exposed
- General authority for regulatory approval, on a joint consultation basis, of other tier 1 or tier 2 instruments on a temporary or permanent basis
- The regulators also can invalidate/modify capital instruments and risk-weighting charges on a case-by-case basis

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Basel III Proposal (cont.)

- Changes to Prompt Corrective Action (PCA) rules:
  - PCA regulations changed to assure consistency with the new regulatory capital requirements
  - PCA capital categories would include a separate requirement for minimum common equity tier 1 capital for top 4 PCA categories (6.5%/4.5%/<4.5%/<3%)
  - "Well-capitalized" DIs would have to have at least 8% tier 1 capital (up from current 6%), and "adequately capitalized" DIs 6% tier 1 capital (up from current 4%)
  - "Adequately capitalized" PCA category for advanced approaches banks would include a minimum 3% supplementary leverage ratio requirement
  - Revisions to the definition of "tangible equity" for critically undercapitalized DIs, and HOLA/savings institutions

Basel III Proposal (cont.)

THE CONTINUING IMPACT OF
Dodd-Frank

- Effective dates/ transitional periods:
  - Minimum tier 1 capital ratios – 2013-2015
  - Minimum total capital: no change and therefore no phase-in
  - Regulatory capital adjustments and deductions – 2013 -2018; goodwill deduction is fully effective in 2013
  - Non-qualifying capital instruments
    - BHCs of $15 BB+ in assets – 2013-2016
    - BHCs under $15BB and all DIs – 2013-2022
  - Capital conservation and countercyclical capital buffers, and related payout ratios – 2016-2019
  - Supplemental leverage ratio for advanced approaches banks – 2018; calculation and reporting required in 2015
  - PCA changes – 2015 (2018 for supplemental leverage ratio)

NPR 1

THE CONTINUING IMPACT OF
Dodd-Frank

Basel III Phase-In Schedule Cheat Sheet

As of Year-End	2012	2013	2014	2015	2016	2017	2018
Minimum Common Equity Capital Ratio	3.50%	4.00%	4.50%	4.50%	4.50%	4.50%	4.50%
Capital Conservation Buffer				**0.625%**	**1.250%**	**1.875%**	**2.50%**
Minimum Common Equity plus Capital Conservation Buffer	3.50%	4.00%	4.50%	5.125%	5.750%	6.375%	7.00%
GSIB Buffer (industry range is 100-250bps; assume WFC will be 100bps)				**0.25%**	**0.50%**	**0.75%**	**1.00%**
Minimum Common Equity plus CCB and GSIB Buffer	3.50%	4.00%	4.50%	5.375%	6.250%	7.125%	8.00%
Minimum Tier 1 Capital	4.50%	5.50%	6.00%	6.00%	6.00%	6.00%	6.00%
Minimum Tier 1 Capital plus Conservation Buffer	4.50%	5.50%	6.00%	6.625%	7.250%	7.875%	8.50%
Minimum Tier 1 Capital plus CCB and GSIB Buffer	4.50%	5.50%	6.00%	6.875%	7.750%	8.625%	9.50%
Minimum Total Capital	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
Minimum Total Capital plus Conservation Buffer	8.00%	8.00%	8.00%	8.625%	9.250%	9.875%	10.50%
Minimum Total Capital plus CCB and GSIB Buffer	8.00%	8.00%	8.00%	8.875%	9.750%	10.625%	11.50%
Countercyclical Capital Buffer					0.625%	1.250%	2.50%
Minimum Total Capital plus CCB, GSIB and Countercyclical Buffer	8.00%	8.00%	8.00%	8.875%	10.375%	11.875%	14.00%

THE CONTINUING IMPACT OF
Dodd-Frank

Comparing Capital Ratio Denominators Under Current Rules (Modified Basel I), Standardized NPR and Advanced Approaches NPR

Modified Basel I Denominator Components

- Asset risk weights
  - OECD sovereigns: 0%
    - Others: 100%
  - OECD banks: 20%
    - Others: 20% short-term; 100% long-term
  - Residential mortgages: 50%
    - 100% if not prudently underwritten
  - Asset-backed securities (optional): ratings dependent
  - Everything else: 100%
- Sample capital calculation
  - $100 million corporate exposure
  - 100% risk weight = $100 million risk weighted assets (RWA)
  - Capital charge = $\frac{\text{Required Capital}}{\text{RWA}}$ = 8%
  - Capital charge: $8 million

Modified Basel I Denominator Components (cont.)

- Off-balance sheet exposures
  - **Credit conversion factors**
    - Unfunded commitments under one year: [0% changed to 10% for US banks]
    - Unfunded commitments over one year: 50%
    - Guarantees: 100%
    - Assets sold with recourse: gross up
  - **Sample capital calculation**
    - $1 billion long-term corporate loan commitment
    - 50% Credit Conversion Factor (CCF) x 100% (risk weight)
      $1 billion x 50% x 100% = $500 million
    - Capital charge = $\frac{\text{Required Capital}}{\text{RWA}}$ = 8%
    - Capital charge = $40 million

Standardized NPR Denominator

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Dodd-Frank

- Standardized total risk-weighted assets
  - Sum of
    1. Total risk-weighted assets for general credit risk
    2. Total risk-weighted assets for cleared transactions and default fund contributions (new)
    3. Total risk-weighted assets for unsettled transactions (new)
    4. Total risk-weighted assets for securitization exposures
    5. Total risk-weighted assets for equity exposures
    6. If applicable, standardized market risk-weighted assets
       Note: No operational risk add-on
  - Minus
    - Allowance for loan and lease losses not included in tier 2 capital

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Advanced Approaches NPR Denominator

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Dodd-Frank

- Advanced approaches total risk-weighted assets
  - Sum of
    1. Credit risk-weighted assets */
    2. Credit Valuation Adjustment risk-weighted assets
    3. Risk-weighted assets for operational risk
    4. If applicable, advanced market risk-weighted assets (i.e., advanced market risk measure x 12.5)
  - Minus
    - Excess eligible credit reserves not included in tier 2 capital

*/ Credit – risk-weighted assets

1.06 x (total wholesale and retail risk-weighted assets plus risk-weighted assets for securitization exposures plus risk-weighted assets for equity exposure)

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Residential Mortgages

THE CONTINUING IMPACT OF Dodd-Frank

- Existing Basel I treatment
  - 50% RW if first, prudently underwritten, owner-occupied, not 90 days past due; otherwise 100%
- BCBS Basel II standardized: generally 35% if meet certain criteria
- US standardized NPR

LTV	Category 1	Category 2
≤ 60%	35%	100%
> 60% & ≤ 80%	50%	100%
> 80% & ≤ 90%	75%	150%
> 90%	100%	200%

  - 50% or less (35%) only for traditional firsts meeting very conservative underwriting AND LTVs of 80% or less (w/o PMI)
    - 75-200% for others

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Advanced Approaches NPR

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- Method to compute RW for wholesale exposures and retail exposures
  - Substantially same as Basel II US final rules
  - Bank must have approved internal risk-rating system to assess rating grades for each wholesale obligor and retail segment
  - RWs a function of:
    - PD (probability of default, based on at least 5 yrs data) (subject to .03 floor unless gov't guaranteed)
    - LGD (loss given default, based on at least 7 yrs severity data) (10% floor for unguaranteed resi-mortgage segments)
    - EAD (exposure at default, based on at least 7 or 5 yrs data for wholesale or retail, respectively)
    - M (for wholesale only, maturity) (must be between one and 5 years unless not part of bank's ongoing financing of obligor)
    - If defaulted, EAD multiplied by .08 then multiply total defaulted by 12.5 (or effectively, 1250%)

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Comparison of Methods to Calculate Securitization Exposure RWs

Ratings Based Approach (Modified Basel I - No Longer Applicable)

Long Term Ratings*	Modified Basel I Risk Weights	Risk Weights Under Basel II US Final Rules		
		Granular Pool		*Non-Granular Pool*
		Senior Exposure	*Non-Senior Exposure*	
AAA	20%	7%	12%	20%
AA		8%	15%	25%
A+	50%	10%	18%	35%
A		12%	20%	
A-		20%	35%	
BBB+	100%	35%	50%	
BBB		60%	75%	
BBB-		100%		
BB+	200%	250%		
BB		425%		
BB-		650%		
B, below or unrated	RBA Not Available	Deduct from tier 1 and tier 2 capital		
Short-Term Ratings				
A-1	20%	7%	12%	20%
A-2	50%	12%	20%	35%
A-3	100%	60%	75%	75%

*** For investing banks, one rating is sufficient. If there are multiple ratings on a particular position, the lowest solicited rating governs**

US Version of SSFA – Standardized and Advanced Approaches NPRs

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- General guidelines
  - Data used must be most currently available and no more than 91 days old
  - If data not available must use 1250% RW
  - RW is higher of (x) RW obtained per SSFA equation and (y) 20%

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US Version of SSFA Parameters

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K_G = Weighted average capital for underlying exposures (between zero and 1)

W = Ratio of delinquent underlying exposures to ending balance of underlying exposures (new, replacing proposed "flexible floor" tied to losses)

A = Attachment point (when losses first are allocated to tranche) (includes subordinated tranches and funded reserves)

D = Detachment point (when total loss occurs – i.e., tranche thickness)

p = Supervisory calibration parameter = .5 for securitization and 1.5 for resecuritization

K_A = $(1 – W) \bullet K_G + (.5 \bullet W)$ (New)

- If $D \leq K_A$, then RW = 1250%
- If $A \geq K_A$ use SSFA equation
- If $A < K_A$ but $D > K_A$ then RW = weighted average of 1250% and RW per SSFA equation

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US Version of SSFA Equation

$$K_{SSFA}\ \frac{e^{a*u} - e^{a*l}}{a(u-l)}$$

where,

$a = -\frac{1}{P * Kg}$

$u = D - Kg$

$l = A - Kg$

e = 2.71828 (the base of the natural logarithms)

RW for exposure = K_{SSFA} x 1250%

Gross-Up Approach (Standardized Approach NPR Only)

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- Calculate RW of underlying assets allocable to exposure <u>plus</u> all senior positions

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US Version of SFA – Advanced Approaches NPR Only

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- The SFA capital requirement for a securitization exposure is UE (underlying exposure) multiplied by TP multiplied by the greater of (i) 0.016[1/*] T; or (ii) S[L+T] – S[L], where:

$$\text{(i)}\ S[Y] = \begin{cases} Y & \text{when } Y \le K_{IRB} \\ K_{IRB} + K[Y] - K[K_{IRB}] + \frac{d \cdot K_{IRB}}{20}\left(1 - e^{\frac{20\cdot(K_{IRB}-Y)}{K_{IRB}}}\right) & \text{when } Y > K_{IRB} \end{cases}$$

$$\text{(ii)}\ K[Y] = (1-h)\cdot\left[(1-\beta[Y;a,b])\cdot Y + \beta[Y;a+1,b]\cdot c\right]$$

$$\text{(iii)}\ h = \left(1 - \frac{K_{IRB}}{EWALGD}\right)^{N}$$

$$\text{(iv)}\ a = g \cdot c$$

$$\text{(v)}\ b = g \cdot (1-c)$$

$$\text{(vi)}\ c = \frac{K_{IRB}}{1-h}$$

$$\text{(vii)}\ g = \frac{(1-c)\cdot c}{f} - 1$$

$$\text{(viii)}\ f = \frac{v + K_{IRB}^{2}}{1-h} - c^2 + \frac{(1-K_{IRB})\cdot K_{IRB} - v}{(1-h)\cdot 1000}$$

$$\text{(ix)}\ v = K_{IRB} \cdot \frac{(EWALGD - K_{IRB}) + .25\cdot(1-EWALGD)}{N}$$

$$\text{(x)}\ d = 1 - (1-h)\cdot(1-\beta[K_{IRB};a,b])$$

[1/] 0.016 is almost three times the multiplier (0.0056) in the US version of Basel II for advanced approaches banks

US Version of SFA Parameters

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TP = Tranche percentage (ratio of bank's exposure to amount of tranche that contains such exposure)

K_{IRB} = Ratio of RBC for underlying exposure plus expected credit losses to UE

L= Credit enhancement level (ratio of (x) subordinated tranches to tranche that contains bank's exposure to (y) UE). May include funded reserve accounts and any first loss discount

T= Thickness (ratio of tranche containing bank's exposure to UE)

N = Effective number of exposures per formula

EWALGD = Exposure – weighted average loss given default per formula; assumes 100% LGD for each securitization exposure in a resecuritization exposure

- If $K_{IRB} \ge L+T$ the RW is 1250%

New Due Diligence Requirements
(Same for Standardized and Advanced Approaches)

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- Failure to comply results in 1250% RW
- Bank must demonstrate "comprehensive understanding of [each] securitization exposure by conducting analysis of risk characteristics prior to acquiring and documenting same within 3 business days after acquisition:
  - Material structural features, such as waterfall, triggers, credit enhancements, liquidity enhancements, market value triggers, servicer performance, and default definitions
  - Underlying exposure performance such as % of 30, 60 and 90 day past dues; default rates; prepayment rates; average-credit scores; average-LTVs; and diversification data
  - Market data such as bid-ask spread, price history, trading volume, implied market rating, and depth of market
  - If a resecuritization, performance information for underlying exposures
- Bank must review and update analysis at least quarterly

Proposed Revisions to Basel Securitization Framework – Introduction

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- Following review of Basel securitization framework, in December 2012, Basel Committee on Banking Supervision (BCBS) issued Consultative Document: Revisions to the Securitization Framework (BCBS 236)
- Comments due March 15, 2013
- Follows implementation of Basel II in many countries and post-financial crisis amendments, known as Basel II.5, to the securitization framework
- During implementation of Basel III changes to bank capital framework
- Follows US bank regulatory proposals to implement Basel II and II.5 as well as Basel III

Hierarchies of Approaches for Calculating Securitization Risk Weights – Two Alternatives

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Alternative A		
1	Modified supervisory formula approach (MSFA)	
	Jurisdiction's choice:	
2	Revised ratings based approach (RRBA) (or internal assessment approach (IAA) if applicable)	Simplified supervisory formula approach (SSFA)
3	Backstop concentration ratio approach (BCRA)	
4	1250% RW	

Alternative B			
	Senior high-quality (SHQ) tranches		Non-SHQ tranches
	Bank's decision:		
1	RRBA /IAA	MSFA /SSFA	Concentration ratio K_{IRB} (CR_{KIRB})
2	BCRA		
3	1250% RW		

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Revised RBA Illustrative RWs

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Illustrative revised RBA risk weights under hierarchy A (%)

(Source: BCBS 236 Table 2; +/- rating levels omitted)

Rating	Senior tranche maturity (years)		Non-senior tranche							
			Thin		Thickness = 0.10		Thickness = 0.25		Thickness = 0.50	
			Maturity (years)		Maturity (years)		Maturity (years)		Maturity (years)	
	1y	5y	1y	5y	1y	5y	1y	5y	1y	5y
AAA	20	58	20	175	20	128	20	94	20	68
AA	51	97	67	306	67	233	64	174	57	122
A	81	141	220	433	212	360	168	250	124	166
BBB	118	203	609	707	476	553	330	383	218	253
BB	170	294	1181	1250	889	1024	601	693	391	450
B	321	485	1250	1250	1250	1250	883	913	565	584
CCC±	472	568	1250	1250	1250	1250	971	971	621	621
< CCC-	1250									

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Liquidity Coverage Ratio Overview

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- The Liquidity coverage ratio (LCR) was officially introduced in December 2010, subject to observation and recalibration by the Basel Committee
- The LCR requires banks to hold a specified stock of high quality liquid assets (HQLA) equaling at least 100% of potential net cash outflows in a 30-day period of stress. The calculation of cash outflows is subject to runoff and drawdown factors specified in the text of the LCR

Purpose and Definition of LCR

- *"Promote short-term resilience of a bank's liquidity risk profile by ensuring that it has sufficient high quality liquid assets to survive a significant **stress scenario for one month.**"*

$$\frac{\text{Stock of High Quality Liquid Assets (HQLA)}}{\text{Total Net Cash Outflows Over the Next 30 Calendar Days}} > 100\%$$

Recalibration of the LCR

- When the LCR was officially introduced by the Basel Committee in December 2010, the standard was subject to an observation and recalibration period ending in mid-2013.
- However, to provide market clarity, the Basel Committee accelerated this recalibration and released a **finalized framework for the LCR on January 6, 2013**.
- The revised framework represented a relaxation of the rules proposed in 2010. Namely, the revised rules:
  - Moderately expanded the types of assets that can be included in the stock of high quality liquid assets, and
  - Reduced the runoff and drawdown factors assumed for calculating cash outflows for stable deposits and certain unfunded lending facility categories.

Scope and Implementation Timeline

- Under the 2010 framework, the LCR would have become fully effective on January 1, 2015 with a fully effective 100% minimum.
- However, the Basel Committee has revised this timeline and established a four-year transition period beginning January 1, 2015, with a full 100% minimum standard effective on January 1, 2019

	January 1,				
	2015	2016	2017	2018	2019
Minimum LCR % Required	60%	70%	80%	90%	100%

- **The LCR will apply to internationally active banks, though national supervisors may choose to apply it to any other banks.**

Drawdown in Periods of Stress

- Upon full implementation, the standard requires that, absent a situation of financial stress, the value of the ratio be no lower than 100% (i.e. the stock of HQLA should at least equal total net cash outflows).
- Banks are expected to meet this requirement continuously and hold a stock of unencumbered HQLA as a defense against the potential onset of liquidity stress. **During a period of financial stress, however, banks may use their stock of HQLA, thereby falling below 100%.**

Source: "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools", Basel Committee on Banking Supervision, January 6, 2013.

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Stock of High Quality Liquid Assets

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The stock of High Quality Liquid Assets (HQLA) constitutes three tiers of asset categories whose inclusion grows more limited with increasing risk profiles

- High quality liquid assets include Level 1, Level 2A, and Level 2B assets.
  - Level 2B assets were added in the 2013 recalibration and represent an easing of eligibility requirements for HQLA.
- Level 1 assets are generally the highest quality and most liquid in the markets during periods of stress, and there is no limit on their inclusion in the stock of HQLA. Level 2 assets comprise Level 2A and Level 2B assets and count toward the minimum standard up to certain limits.
- **Debt and equity issued by financial institutions are ineligible for inclusion in the stock of high quality liquid assets.**

100% Level 1 Assets — *Level 1 assets can constitute an unlimited share of the pool and are not subject to a haircut under the LCR.*

40% Level 2 Assets — *Level 2A Assets receive a 15% haircut. The haircut amount may constitute up to 40% of the stock of HQLA.*

15% Level 2B Assets — *Level 2B Assets in total may constitute up to 15% of the stock of liquid assets after the application of haircuts. This 15% limit is a subset of the 40% limit for Level 2 Assets.*

Source: Wells Fargo Securities.

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General Characteristics of High Quality Liquid Assets

High Quality Liquid Assets ("HQLA") constitute "unencumbered"[1] assets that can easily and immediately be converted into cash, with minimal impact to the value of the assets.
The Basel Committee has established several fundamental and market-related characteristics to determine which assets should be included in the stock of HQLA in calculating the LCR.

Fundamental Characteristics	
Low risk	***Less risky assets typically have higher liquidity.*** High credit standing and low degree of subordination increases liquidity. Low duration, low legal risk, low inflation risk, and low foreign exchange risk enhance liquidity.
Ease and certainty of valuation	***Assets with more standard and simple structures tend to be more liquid.*** Pricing of a high quality liquid asset must be based on public information, with minimal assumptions. Most structured and exotic products will be excluded from high quality liquid assets.
Low correlation with risky assets	***High quality liquid assets should not be highly correlated with risky assets.***
Listed on a developed and recognized exchange	***Listed assets have increased transparency, typically resulting in higher liquidity.***
Market-Related Characteristics	
Active and sizable market	***High quality liquid assets must have active sale or repo markets at all times.*** Historical evidence of market breadth and depth. Assets should demonstate low bid-ask spreads and high trading volumes. Large and diverse number of market participants.
Low volatility	***Low volatility of traded prices and spreads will enhance liquidity.*** Assets with relatively stable prices and lower inclination to sharp price declines will have lower probability of triggering forced sales. Historical evidence of relative stability during stressed market periods.
Flight to quality	***Flight to quality assets have higher liquidity, especially during a systemic crisis.***

Source: "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools." Basel Committee on Banking Supervision, January 2013.
[1] According to the Basel Committee, "unencumbered" means free of legal, regulatory, contractual or other restrictions on the ability of the bank to liquidate, sell, transfer, or assign the asset.

High Quality Liquid Assets – Level 1 Assets

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Level 1 Assets are intended to encompass the highest quality and most liquid assets.
Level 1 Assets can constitute 100% of the pool of high quality liquid assets and are not subject to haircuts. However, haircuts may be applied on a jurisdictional basis based on, among other things, duration, credit and liquidity risk, and typical repo haircuts.

Level 1 Assets (**No limit** on proportion of HQLA)	Haircut
▪ Cash. ▪ Central bank reserves (including required reserves).[1] ▪ Certain marketable securities representing claims on or guaranteed by sovereigns, central banks, public sector entities ("PSEs"), the Bank for International Settlements, the International Monetary Fund, the European Central Bank and European Community, or **multilateral development banks ("MDBs").** *Eligibility Criteria* ▪ **Assigned a 0% risk weight under the Basel II Standardized Approach;** ▪ Traded in large, deep and active repo or cash markets characterized by a low level of concentration; ▪ Proven record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions; and, ▪ **Not an obligation of a financial institution or any of its affiliated entities.** ▪ Sovereign and central bank debt securities with > 0% risk weight under the Basel II Standardized Approach are also eligible for inclusion in Level 1 Assets. *Eligibility Criteria* ▪ Issued in domestic currencies in the bank's home country or the country in which the liquidity risk is being taken; and, ▪ Issued in foreign currencies, up to the amount of the bank's stressed net cash outflows in that specific foreign currency stemming from the bank's operations in the jurisdiction where the bank's liquidity risk is being taken.	0%

Considerations	▪ Level 1 Assets include GNMA MBS securities given the unconditional guarantee by the U.S. government, but do not include FNMA or FHLMC MBS. ▪ It is expected that U.S. rulemaking will be adjusted to include FNMA and FHLMC MBS securities as Level 1 Assets. ▪ Multilateral development banks, such as KFW, would be eligible to be treated as Level 1 assets.

Source: "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools." Basel Committee on Banking Supervision, January 2013.
[1] To the extent that the central bank policies allow reserves to be drawn down in times of stress.
[2] Up to the amount of the bank's stressed net cash outflows in that specific foreign currency stemming from the bank's operations in the jurisdiction where the bank's liquidity risk is being taken.

High Quality Liquid Assets – Level 2 Assets

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Level 2 Assets include comparatively riskier and less liquid assets than Level 1 assets and are divided into Level 2A and Level 2B assets, with varying haircuts applied to each level.
After the application of certain haircuts, total Level 2 Assets can account up to 40% of a bank's high quality liquid assets.

Level 2 Assets
(Capped at **40%** of total HQLA)

Level 2A Assets	Haircut
▪ Certain marketable securities, representing **claims on or guaranteed by sovereigns, central banks, public sector entities ("PSEs"), or multilateral development banks ("MDBs")**. *Eligibility Criteria* ▪ Assigned a **20% risk-weight** under the Basel II Standardized Approach; ▪ Traded in large, deep and active repo or cash markets characterized by a low level of concentration; ▪ Proven record as a reliable source of liquidity in the markets even during stressed market conditions; and, ▪ **Not an obligation of a financial institution or any of its affiliated entities.** ▪ "Plain-vanilla" **senior corporate debt securities** (including **commercial paper**) and **covered bonds**. *Eligibility Criteria* ▪ **Not issued by a financial institution** or any of its affiliated entities (in the case of corporate debt securities); ▪ Not issued by the bank itself or any of its affiliated entities (in the case of covered bonds); ▪ Long-term credit **rating of AA- or higher** (or equivalent short-term rating); ▪ Traded in large, deep and active repo or cash markets characterized by a low level of concentration; and, ▪ Proven record as a reliable source of liquidity in the markets even during stressed market conditions.	15%

Considerations

- PSE obligations with a 20% risk-weight under the proposed Standardized Approach rules include FNMA and FHLMC MBS, U.S. agency debt (including debt issued by FNMA, FHLMC, and FHLB), and general obligation municipal bonds.

Source: "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools." Basel Committee on Banking Supervision, January 2013.

High Quality Liquid Assets – Level 2 Assets (cont.)

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Level 2B Assets may be included in Level 2 Assets at the discretion of national supervisors in different jurisdictions.
Level 2B assets are limited to 15% of total high quality liquid assets and receive greater haircuts than Level 2A Assets.

Level 2 Assets
(Capped at **40%** of total HQLA)

Level 2B Assets (Capped at **15%** of total HQLA)	Haircut
▪ Non-agency residential mortgage-backed securities ("RMBS"). *Eligibility Criteria* ▪ Not issued by and the underlying assets have not been originated by the bank itself or any of its affiliated entities; ▪ Long-term credit rating of AA or higher (or equivalent); ▪ **Underlying mortgages are full recourse loans** and have a maximum loan-to-value ratio of 80% on average at issuance; ▪ Subject to risk-retention regulations, which require issuers to retain an interest in the assets they securitize; ▪ Traded in large, deep and active repo or cash markets characterized by a low level of concentration; and, ▪ Proven record as a reliable source of liquidity in the markets even during stressed market conditions.	25%
▪ "Plain vanilla" senior corporate debt securities (including commercial paper) with a long-term credit rating of between A+ and BBB- (or equivalent). ▪ Common equity shares meeting the following criteria: ▪ **Not issued by a financial institution or any of its affiliated entities;** ▪ Exchange traded and centrally cleared in major stock index in the home jurisdiction or where the liquidity risk is taken; ▪ Traded in large, deep and active repo or cash markets characterized by a low level of concentration; and, ▪ Proven record as a reliable source of liquidity in the markets even during stressed market conditions.	50%

Considerations

- Underlying mortgages must be full recourse and geographically diversified, which could make certain RMBS in the U.S. ineligible under this calibration.
  - At least 11 states in the U.S. are classified as non-recourse states.
- Every RMBS pool will need to be evaluated to determine what may be included in RMBS in the U.S. LCR.

Source: "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools." Basel Committee on Banking Supervision, January 2013.

Significant Changes Affecting Outflow Calculations

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Deposits

- Under the 2010 LCR framework, "stable deposits" (i.e., the amount of deposits covered by an effective deposit insurance program) had a minimum runoff assumption of 5% for purposes of calculating cash outflows.
- In the 2013 recalibration, the minimum runoff factor was lowered to 3% for deposits insured by deposit insurance programs meeting criteria specified by the Basel Committee.
- The cash outflow rate for "non-operational" deposits provided by non-financial corporates, sovereigns, central banks, and PSEs was reduced from 75% to 40%.
  - Insured or publicly guaranteed "non-operational" deposits will have a 20% runoff rate.

Unfunded Commitment Runoff

- Under Basel III, credit and liquidity facilities are defined as explicit contractual agreements and/or obligations (commitments) to extend funds at a future date to retail or wholesale counterparties.
- Within the LCR framework, a liquidity facility is defined as "*any committed, undrawn back-up facility that would be used to refinance the debt of a customer in situations where such a customer is unable to rollover that debt in the financial markets.*"
  - General working capital facilities for corporate entities will not be classified as liquidity facilities, but as credit facilities.
  - Liquidity facilities backing obligations **maturing in more than 30 days will be excluded** from the definition of "liquidity facility."
- The LCR revisions on January 6, 2013 significantly relaxed the drawdown assumptions required for unfunded commitments extended by a bank.
  - Original drawdown assumptions, including a 100% drawdown assumption for all liquidity facilities, appeared to be extreme and not based on empirical data.
  - Liquidity facilities extended to financial institutions (other than prudentially regulated banks) will continue to be subject to a 100% drawdown assumption.

Credit & Liquidity Facility Treatment

	2010 Calibration		2013 Revised Calibration	
	Credit Facilities	Liquidity Facilities	Credit Facilities	Liquidity Facilities
Retail Small Business	5%	5%	5%	5%
Non-Financial Corporates, Sovereigns, Central Banks, Public Sector Entities and Multilateral Development Banks	10%	100%	10%	30%
Banks Subject to Prudential Supervision	100%	100%	40%	40%
Other Financial Institutions (including Securities Firms and Insurers)	100%	100%	40%	100%
Other Legal Entities (SPEs, Conduits, and SPVs)	100%	100%	100%	100%

Source: Basel Committee on Banking Supervision.

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What's Next for Bank Liquidity?

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While the LCR has been finalized at the Basel Committee level, work remains to finalize the Net Stable Funding Ratio (NSFR) and for national regulators to implement the LCR in their own jurisdictions

Net Stable Funding Ratio ("NSFR")

- With work on the LCR complete, the Basel Committee has stated it will turn its attention to finalizing the NSFR.
- Despite the transitional arrangements adopted for the LCR, the Basel Committee has stated its commitment to adopt the NSFR as a minimum requirement by January 1, 2018.

U.S. Proposal Rulemaking

- The U.S. federal banking agencies are expected to release a proposed rule for implementing the LCR in the U.S. around mid-year.
- However, the proposal is subject to an inter-agency approval process which would cause unpredictability in the timing of the release.
- Importantly, the Dodd-Frank Act prohibits references to credit ratings in regulations, requiring U.S. federal banking agencies to modify aspects of the LCR.
  - The Basel Committee will continue to assess the comparability of model-based internal ratings approaches to external ratings.

Section 165/166 Final Rulemaking

- Sections 165 and 166 establish enhanced prudential standards (including capital buffers and **liquidity risk management requirements**) and early remediation requirements for systemically important financial institutions in the U.S.
- A proposed rule implementing Section 165 and 166 of the Dodd-Frank Act covering U.S. activities of foreign banking operations was released on December 14, 2012.
- A final rule applicable to U.S. bank holding companies under Sections 165 and 166 of the Dodd-Frank Act could be released during **1H2013**, following proposed rules in December 2011 and comments received on the proposals for both U.S. institutions and foreign banking institutions.

Source: "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools", Basel Committee on Banking Supervision, January 6, 2013.

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Questions?

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Tab 8

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"Frames issues in a business context and clearly illustrates the pros and cons of alternative strategies."
Legal 500 2011

Scott Anenberg is co-head of the Firm's Financial Services Regulatory and Enforcement Practice. He has over 25 years of experience representing global and domestic commercial banks, thrifts, and other financial services companies, as well as their holding companies and affiliates, on a wide variety of strategic, regulatory, compliance, and enforcement issues before federal and state agencies. Scott has consistently been ranked by *Chambers USA* and *Legal500* and he is noted for being "client focused and proactive in identifying relevant regulatory proposals and explaining their impact," *Chambers USA 2011*. *Legal 500* says Scott is “...the ‘go-to person for every complicated or nettlesome issue’, and is particularly strong at advising on banking compliance matters.”

He regularly advises banking and financial services clients on legislative and regulatory developments; geographic and product expansion; acquisitions and reorganizations; anti-money laundering, USA PATRIOT Act and Bank Secrecy Act compliance; preemption; privacy; transactions with affiliates; regulatory capital; consumer compliance; and electronic banking and commerce.

Earlier in his career, Scott worked for the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency. He is also active in the firm’s Israel-related practice.

Experience

- Advising financial institutions on the strategic and operational implications of the "Dodd-Frank Wall Street Reform and Consumer Protection Act".
- Represented the sellers in the seventh largest US bank merger announced in 2008.
- Represented a foreign bank in several transactions designed to rationalize and consolidate its US operations, including precedent-setting transfers of its FDIC-insured branches to its US bank subsidiary made possible by first obtaining an innovative ruling from the FDIC under the Riegle-Neal Interstate Banking Act.
- Helped a federal savings bank in establishing the first-of-its-kind REIT subsidiary as a vehicle to issue tax-advantaged Tier 1 capital.
- Represented a foreign bank in US matters relating to its privatization and subsequent sale of its New York bank subsidiary.

- Advised the US subsidiary of a foreign bank in its acquisition from the FDIC of a failed Florida bank, culminating in a strategy designed to enable the bank to better serve its customer base and pursue new business opportunities in Florida despite that state's restrictive interstate banking laws.
- Represented a large insurance company in various regulatory and enforcement matters relating to its ownership of a thrift.
- Assisted several banks with reviews, internal investigations and potential enforcement actions related to anti-money laundering issues.
- Helped several foreign banks apply to establish branches, representative offices and agencies in the US.
- Helped a major financial services trade group obtain amendments to various aspects of the FDIC's regulations governing US branches of foreign banks.
- Represented domestic and foreign banking clients in establishing securities brokerage subsidiaries in order to comply with the "push-out" provisions of the Gramm-Leach-Bliley Act.
- Obtained the first official interpretation involving the application of FDIC deposit insurance rules to electronic banking products.

Education

- The George Washington University Law School, JD, with high honors, 1978
- Washington University, BA, magna cum laude, 1975; Order of the Coif

Admissions

- District of Columbia, 1978

Activities

- American Bar Association, Banking Law Committee
- Contributing Editor, Electronic Banking Law and Commerce Report (2000-2008)

News & Publications

- "Banking Regulation To Watch In 2013," *Law360*, 1 January 2013
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- Private Equity Investments in Bank and Thrift Institutions: What is the Current State of Play?, 14 January 2010

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Alexandria Carr is a qualified barrister practising in London as Of Counsel with the Financial Services, Regulatory & Enforcement group. She has worked for the UK government for 13 years, the last 5 of which she has spent at the UK's ministry of finance, HM Treasury, working closely with people across government, the FSA, the Bank of England, ministries of finance across Europe and the institutions of the EU.

Alexandria has acted as the lead legal adviser on EU financial services strategy with a specific focus on the new EU financial services supervisory architecture. She has been the lawyer on the UK team that negotiated the European System of Financial Supervision (ESFS) (that established the new European Supervisory Authorities) and implemented the ESFS in the UK. Since the establishment of the ESFS in January 2011, she has advised HM Treasury on the changes it has made to the regulation and supervision of financial services.

She has also advised HM Treasury on the EU's response to the financial crisis more generally as the EU seeks to reduce the discretion of individual Member States to legislate domestically and to develop a single EU rulebook for financial services. In addition, Alexandria was the lawyer on the UK teams negotiating Solvency II, the short selling regulation and the proposed market abuse regulation currently being negotiated. She also has advised HM Treasury on the new system for making subordinate EU financial services legislation (what is known as "level 2") post the Lisbon Treaty. Alexandria also has experience of regulation on a purely domestic level, having, for example, drafted the legislation which regulated Islamic finance and created a protected cell regime for Open Ended Investment Companies.

Admissions

- England and Wales, 1997

News & Publications

- "UK challenges 'illegal' EU power to ban short-selling," *The Daily Telegraph*, 11 June 2013
- "U.K. Contests 'Unpredictable' EU Powers to Ban Short Selling," *The Washington Post*, 11 June 2013
- "U.K. Fights 'Unpredictable' EU Power to Ban Short Selling," *Bloomberg*, 11 June 2013
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- "Banking union dealt fresh blow amid fears for City," *The Times* *(subscription required)*, 5 December 2012
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- "Short Selling and Credit Default Swaps - New EU Rules Enter into Force on 1 November 2012," *Mayer Brown Legal Update*, 30 October 2012
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- "European Commission creates banking union," *Reuters*, 12 September 2012
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- Cross-Border Restructuring Institute Webinar Series: Regulatory Approaches to Troubled Financial Institutions—Dodd-Frank, Living Wills and Non-US Approaches, 10 October 2012
- Banking Union: A Solution to the Eurozone Sovereign Debt Crisis?, 27 September 2012
- A Single European Rulebook. A Single European Regulator?, 12 July 2012

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Josh Cohn is the head of Mayer Brown's US Derivatives & Structured Products practice and co-leader of the global Derivatives & Structured Products practice. He concentrates his practice on derivatives and has extensive experience as US counsel to the International Swaps and Derivatives Association (ISDA), and represents dealers and end-users in a wide range of transactions.

Prior to joining Mayer Brown from Allen & Overy, Josh was the Derivatives Counsel at Cravath Swaine & Moore in New York; a Senior Vice President and General Counsel at DKB Financial Products, Inc.; a First Vice President and Counsel at Security Pacific National Bank; an Associate at LeBoeuf, Lamb, Leiby & Macrae; and a Law Clerk at the US Court of Appeals - Ninth Circuit, San Francisco, CA.

Josh is listed for derivatives law in The Best Lawyers in America while the *IFLR 1000* and *The Legal 500* list Josh as one of the world's leading derivatives lawyers. Josh has been ranked in band 1 of *Chambers USA* since 2008. In 2012, clients described Josh as having "an almost encyclopedic knowledge of the derivatives market." In 2010, sources noted his "great depth of experience and understanding of market trends." In 2008 and 2009, clients noted he "…is one of the greats in derivatives because of his extensive knowledge" and that he is "doubtless one of the best derivatives lawyers in the world."

Education

- New York University School of Law, JD
- Columbia College, BA

News & Publications

- "The ISDA March 2013 Dodd-Frank Protocol (the "DF Protocol 2.0") is Open for Adherence," *Mayer Brown Legal Update*, 17 May 2013
- "CFTC Mandatory Clearing Rules – June 10 Phase-in Date for Financial Entities," *Mayer Brown Legal Update*, 16 May 2013
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- Fundamentals of Swaps and Other Derivatives 2011, 17 October 2011
- Dodd-Frank: One Year Later, 27 July 2011
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- Hot Topics in Insurance Regulation, 30 September 2010
- Greek Sovereign Default: What Happens Next?, 18 May 2010

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Tom Delaney is a partner in Mayer Brown's Washington DC office and represents a broad range of financial services organizations. He assists both US-based and international firms to anticipate and resolve regulatory, supervisory, and structural impediments to their corporate objectives. Tom possesses a comprehensive knowledge of US financial services law, with particular emphasis on funds transfer matters that arise in the context of anti-money laundering (Bank Secrecy Act and USA Patriot Act) and sanctions compliance. His practice includes assisting internationally active firms to reconcile and comply with overlapping and potentially conflicting provisions of US and international law. Recently, he has devoted substantial time to counseling clients on complying with the new requirements mandated by the Dodd-Frank Act. Tom oversees the conduct of internal investigations and defends financial services firms that are the subject of enforcement proceedings and Congressional investigations.

Tom is highly respected for his insightful corporate and regulatory counsel and for his demonstrated success in providing thoughtful strategic advice to organizations facing long-term threats to their operational viability or reputational integrity. *Chambers USA 2012* notes that Tom "has a good understanding of the process of governmental agencies and sets a very good tone in working with the government."

Tom has been practicing law for more than 25 years, initially as an attorney with the US Treasury Department's Office of Thrift Supervision. He entered private practice in 1991 and joined Mayer Brown in 2006. Prior to practicing law, he served on the staff of the Committee on Financial Services of the US House of Representatives and on the staff of the US Senate. He has represented clients before the Federal Reserve, the Department of Treasury, the Federal Deposit Insurance Corporation (FDIC), the Securities and Exchange Commission (SEC), the Financial Crimes Enforcement Network (FinCEN), the Office of Foreign Assets Control (OFAC), and the Consumer Finance Protection Bureau (CFPB). Also, he has appeared before various state authorities, including in New York, California, Illinois, Florida, and the District of Columbia. In addition to financial services firms, Tom has advised foreign governments on their establishment of regulatory and enforcement systems that conform with international standards, including those specified by such bodies as the OECD's Financial Action Task Force.

Education

- American University Washington College of Law, JD, 1986
- Georgetown University, BA, 1979

Admissions

- District of Columbia, 1995
- New Jersey, 1987
- Pennsylvania, 1987

Activities

- American Bar Association, Section of Business Law

News & Publications

- "Federal Reserve Proposes Enhanced Prudential Standards for Non-US Banking Organizations," *Mayer Brown Legal Update*, 20 December 2012
- "US FDIC and Federal Reserve Propose Rule on Resolution Plans and Credit Exposure Reports," *Mayer Brown Legal Update*, 2 May 2011
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  Ranked in 2010 Edition of IFLR1000," 9 October 2009
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- "International Financial Law Review ranks 20 Mayer Brown lawyers; 21 practices in IFLR1000," 6 November 2008
- "U.S. Sanctions: The New Trans-Atlantic Challenges," 24 April 2007
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- Banking and Financial Services Mid Term Election Impact, 29 October 2010

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Chris Gavin concentrates his practice on US and international structured finance transactions, including in emerging markets. He acts for a broad range of financial institutions, including banks, official lenders, and hedge funds. He has represented clients in the structuring and negotiation of:

- Cross-border asset-backed securitization and financing transactions involving construction loans, mortgage loans, auto loans, sovereign debt, trade receivables in emerging markets and future flow oil exports in Africa;
- Cross-border covered bonds;
- Collateralized commercial paper programs;
- Structured distressed portfolio solutions for financial institutions;
- Structured solutions for exposures arising out of M&A deals;
- Repos for distressed residential loans and whole loan sales;
- Residential mortgage-backed securities, warehouse facilities and investment vehicles that issue extendable commercial paper, including the working out and resolution of such vehicles;
- Market value swaps, currency swaps and interest rate swaps in connection with numerous domestic and cross border structured finance transactions.

Chris also has extensive experience securitizing and financing many other types of assets and projects, including auto loans and leases, commercial mortgage loans, home equity lines of credit, franchise loans, life insurance policy loans, mortgage servicing rights, toll road projects and forward sale commodity contracts. Chris has regularly represented a significant market participant in residential mortgage securitization related litigation and government investigations.

Chris was named a Leading Lawyer for Structured Finance/Securitization and Capital Markets in 2012 by *IFLR* and a Rising Star in Illinois in 2009 and 2010 and in New York in 2011 by *Super Lawyers*.

Chris's talent for innovation and creativity has been recognized by *Financial Times'* "Innovative Lawyers" survey, which ranked a risk protection arrangement for Assured Guaranty that he helped design as the second most innovative M&A transaction of 2010, a pro bono financing facility that he helped structure for a microfinance institution that was beginning to provide loans in Africa as one of its commended responsible business initiatives of 2010, and a novel collateralized commercial paper program he helped structure for a large international financial institution as one of the 'standout' financings of 2011.

Experience

- Represented Barclays Bank PLC and Barclays Capital Inc. in establishing what is believed to be the first collateralized commercial paper program.
- Represented Banco Popular de Puerto Rico in the sale of a portfolio of distressed construction and commercial real estate loans to a newly created joint venture that is majority owned by a limited liability company created by Goldman Sachs and Caribbean Property Group and financed in part by seller financing.
- Represented Banco Popular North America in connection with the sale of a portfolio of nonperforming mortgage loans, including in setting the bid process and negotiating the sale and purchase agreement and the interim servicing arrangements.
- Advised BRAC, a not-for-profit microfinance and developmental organization in Bangladesh, on a syndicated credit facility. $63 million was raised from several international lending groups, including the Overseas Private Investment Corporation (OPIC), to develop microfinance lending operations in Tanzania, Uganda and Southern Sudan.
- Represented a major US-based monoline insurance company in its purchase of one of its competitors. The transaction included a series of protection arrangements provided by the seller that were structured as swap agreements to protect the client from exposure to the purchased monoline's guaranteed investment contact business. The seller's obligations under these protection arrangements were guaranteed in part by the two major European governments.
- Represented the arrangers and initial purchasers in the resecuritization of approximately $4.7 billion of residential mortgage-backed securities (RMBS) for a major US financial institution. The underlying collateral consisted of approximately 350 US RMBS from 350 different underlying transactions. The deal assisted the financial institution to further strengthen its balance sheet by significantly reducing its remaining exposure to the US residential real estate market.
- Represented Popular, Inc. in an agreement to sell $1.2 billion in loan and servicing assets of its US mortgage subsidiary, Popular Financial Holdings, to various affiliates of a leading financial services firm.
- Represented a potential hedge fund investor in the creation of a novel structure for a distressed financial institution that would have included a joint venture for the purchase of distressed residential mortgage loans and REO and a significant Tier I investment and warrants in the institution.
- Represented the initial purchaser in two Peso 1 billion+ securitizations of construction loans for low and middle income residential properties in a Mexico, originated by two different Mexican finance companies.
- Represented the arranger in structuring a US$330 million variable funded note warehouse facility with a partial credit guarantee from OPIC (Overseas Private Investment Corporation).
- Represented a lender in connection with a significant loan secured by forward sales of crude oil by a national oil company in northern Africa.
- Represented the purchaser of US$194 million of CRPAOs (payment obligations of the Government of Peru) issued to the concessionaire for the Tramo 1 section of the IIRSA Sur toll road project in Peru.
- Structured and negotiated multiple home equity loan securitization transactions issuing both public and private securities, including REMIC, non-REMIC and Re-REMIC structures.
- Structured and negotiated several cross border mortgage loan securitization transactions, including transactions issuing publicly registered asset-backed securities.

- Structured and negotiated numerous novel warehouse financing vehicles for mortgage loan originators.

Education

- DePaul University College of Law, JD, with highest honors, 1999; Order of the Coif, Dean's Scholarship, Editorial Board, and Research and Writing Assistant, *DePaul University Law Review*
- The University of Iowa, BA, 1994; Dean's List

Admissions

- Illinois, 1999
- New York

Activities

- American Securitization Forum

News & Publications

- "Mayer Brown advises on transaction named 2012 "Structured Financing Deal of the Year" by *LatinFinance*," 14 February 2013
- "American Lawyer Pro Bono Issue," *ALM*, 1 July 2009

Events

- The Continuing Impact of Dodd-Frank, 26 June 2013
- The Securitization and Structured Finance in Latin America Conference, 16-17 May 2013
- Strategies for Dealing with Financial Asset Businesses and Portfolios—Part III: Joint Ventures and Restructurings for Financial Asset Businesses and Distressed Portfolios, 22 March 2011
- Microfinance USA 2011 Conference, New York, 2011
- "Strategies for Managing Distressed Bank Portfolios," Global Financial Markets Initiative, 2011
- "The Growth of and Challenges for International and Domestic Microfinance," Microfinance Symposium, The New York State Bar Association International Section, New York, 2010
- "Rebuilding the Mortgage Market, Loan by Loan," PWC/BNY Mellon, Washington DC, 2009
- "Weathering the Storm: MBS Originators, Investors & Servicers Speak Out," ABS East, 2008

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Tim Keeler, an attorney in the Government and International Trade Group, joined Mayer Brown in 2009, and brings an in-depth knowledge of international trade law and economic policy matters, and a history of working in the Executive Branch and Congress on major economic, legislative and regulatory issues.

Tim provides legal and strategic advice to clients on matters including:

- The consistency of various legal regimes – or proposed laws – with World Trade Organization (WTO) rules and other international legal obligations
- Committee on Foreign Investment in the U.S. (CFIUS) filings on proposed transactions of foreign investment
- International trade negotiations in the WTO and bilateral or regional fora
- WTO and other international trade agreement litigation
- International economic, political, and legal events and actions that effect businesses and investors
- The U.S. economic decision making process in the Administration and Congress
- The political climate in various countries that are pertinent to clients' business activities
- Advocacy on behalf of clients to the U.S. government and to foreign governments

Prior to joining Mayer Brown, Tim served in a variety of senior positions in the U.S. Government for almost 12 years. Most recently he was the Chief of Staff in the Office of the U.S. Trade Representative (USTR) from 2006 - 2009, where he oversaw implementation of U.S. policy, strategy and negotiations involving all aspects of international trade and investment matters. He worked on a number of key issues including: climate change and trade; US and China relations; WTO negotiations and litigation; free trade agreement negotiations and implementation; and CFIUS decisions.

Before working for USTR, Tim spent more than five years at the Treasury Department from 2001 – 2006. He joined the Office of Legislative Affairs in 2001 as a Deputy to the Assistant Secretary for International Issues, where he was responsible for Treasury's legislative strategy on issues including capital market sanctions, foreign exchange rate policy testimony, appropriations for U.S. agreements to replenish the World Bank and other Multilateral Development Banks, multilateral debt relief, and U.S. participation in the International Monetary Fund. He later managed the Office of Legislative Affairs from 2002 - 2006 and assisted on all policy and personnel issues in the Office. This included leading Treasury nominees through the U.S. Senate confirmation process, legislative strategy on Treasury Intelligence and Terrorist Financing matters, and advising on major economic legislative initiatives such as the 2003 tax cuts and social security reform proposals.

Tim also served on the Presidential Transition Team in 2000–2001 as a policy coordinator on export control and trade remedy policy, handling the Commerce Department's Bureau of Export Administration (now called the Bureau of Industry and Security) and the International Trade Commission (ITC).

Earlier in his career, Tim served as a professional staff member for international trade on the US Senate Finance Committee under Chairman William V. Roth (R-DE). There he worked on legislation establishing permanent normal trade relations (PNTR) between the U.S. and China, preferential trade programs for Sub-Saharan Africa (the African Growth and Opportunity Act) and the Caribbean basin, the Generalized System of Preferences, legislation to bring the U.S. into compliance with the WTO decision on the Foreign Sales Corporation provisions of the Internal Revenue Code, and the miscellaneous tariff bill.

In recognition of his government service, Tim was awarded the USTR Distinguished Service Award, the Treasury Distinguished Service Award, and the Treasury Secretary's Honor Award twice.

Tim is also an adjunct professor at the Georgetown University School of Law, co-teaching a course on U.S. and WTO law, policy, and politics; is a member of the Board of Directors of the Washington International Trade Foundation; and is a term member of the Council on Foreign Relations. Tim has spoken at conferences on international trade and economic issues sponsored by, *inter alia*, the American Bar Association (Climate Change and Trade, March 2009), the Korea Economic Institute (the U.S. – Korea Free Trade Agreement, October 2010), and the U.S.-China Business Council (Sec. 421 tires safeguard case, July 2009; and the U.S. – China Economic and Political Relationship, January 2010).

Education

- Tulane University BSE, Engineering Science
- George Mason University School of Law, JD, magna cum laude Associate Editor, George Mason Law Review

Admissions

- New Jersey
- District of Columbia

Activities

- Adjunct professor of law, Georgetown School of Law
- Member, Board of Directors, the Washington International Trade Foundation
- Term Member, Council on Foreign Relations

News & Publications

- "Can A Huge Hog Deal Pose A National Security Risk?," *NPR*, 31 May 2013
- "Ralls CFIUS block alters Sany's future investment strategy in US," *The Financial Times*, 1 March 2013

- "Transatlantic Free Trade Agreement Presents Opportunity for US and EU Businesses," *Mayer Brown Legal Update*, 19 February 2013
- "Asia-Pacific Economic Cooperation," *Bloomberg BNA's Tax Planning International - Indirect Taxes*, October 2012
- "New International Services Agreement Will Tackle Trade Barriers," *Mayer Brown Legal Update*, 18 January 2013
- "奥巴马总统命令撤出中国对美国风场的投资；投资者面临前所未有的法律挑战," *Mayer Brown Legal Update*, 2 November 2012
- "Playing Hardball With Chinese Investors," *The Wall Street Journal*, 25 October 2012
- "Failed U.S. Deals Stir Tensions With China," *The Wall Street Journal (subscription required)*, 18 October 2012
- "President Obama Orders Divestiture of Chinese Investment in US Wind Farms; Investor Mounts Unprecedented Legal Challenge," *Mayer Brown Legal Update*, 5 October 2012
- "APEC Members Agree to Reduce Tariffs, Promote Green Growth and Boost Regional Trade for Approved List of Environmental Goods," *Mayer Brown Legal Update*, 14 September 2012
- "US International Trade Commission Launching Two Investigations Concerning WTO Information Technology Agreement," *Mayer Brown Legal Update*, 13 August 2012
- "Russia Prepares to Join the WTO," *Mayer Brown Legal Update*, 23 July 2012
- "Chinese Firm Pursues Hawker," *The Wall Street Journal (subscription required)*, 9 July 2012
- "Russia Set to Introduce Recycling Fees for Cars," *Mayer Brown Legal Update*, 25 June 2012
- "俄罗斯政府将入世议定书提交俄罗斯议会批准," *Mayer Brown Legal Update*, 15 June 2012
- "US Bilateral Investment Treaties: Recent Developments," *Mayer Brown Legal Update*, 11 June 2012
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- "USTR Seeks Comments on Japan, Canada, and Mexico Joining Trans-Pacific Partnership Talks," *Mayer Brown Legal Update*, 9 December 2011
- "EU-US Relations: Transatlantic Economic Council to Meet on November 29, 2011," *Mayer Brown Legal Update*, 17 November 2011
- "Russia's Long Road to the WTO is Over," *Mayer Brown Legal Update*, 11 November 2011
- "United States Announces Resolution of Dispute Over Chinese Wind Power Subsidies," *Mayer Brown Legal Update*, 8 June 2011
- "US Trade Representative Seeking Comments on Expansion of Information Technology Agreement – Negotiation Qualifies for Rarely Used Presidential Tariff Reduction Authority," *Mayer Brown Legal Update*, 12 May 2011
- "China's New M&A Review Rules: A Comparison with the US," *Pratical Law Company*, 1 March 2011
- "US National Security Review Disapproves Completed Chinese Acquisition — Huawei Agrees to Withdraw from 3Leaf Deal," *Mayer Brown Legal Update*, 23 February 2011
- "United States Seeks WTO Dispute Settlement Consultations on China's Support for its Domestic Wind Power Industry," *Mayer Brown Legal Update*, 27 December 2010
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"An incredible legal strategist and a fantastic leader."

"'His academic and practical contribution to the field is outstanding,' say observers, adding that he 'wrote the book on securitization, literally' and 'has played a pivotal role in many regulatory initiatives.'" Chambers USA

Jason H.P. Kravitt is a partner based in New York at the international law firm of Mayer Brown, which is one of the 15 largest law firms in the world. He served as the Co-Chairman of the firm's Management Committee from June 1998 through June 2001 and served on that Committee from June 1997 until June 2009. Jason is also the founder of the firm's securitization practice (one of the most highly rated law firm securitization practices in each of the US, Europe and Asia, by Chambers and Partners Rating Service ("*Chambers*") and all other law firm rating services) and senior partner in that practice, and participates in a variety of finance and regulatory related practices. Jason has participated in or chaired numerous professional and law school seminars and conferences on securitization and written numerous articles for legal journals and professional publications, is Editor of, and a contributing author to, the two-volume treatise, *Securitization of Financial Assets*, Aspen Law & Business (2d ed. 2011), generally accepted as the seminal treatise in the industry, is on the Advisory Boards of *The Financier*, *The Securitization Conduit* and *American Securitization* publications, is an Adjunct Professor of Law at each of Northwestern University Law School and New York University Law School, an Adjunct Professor of Finance at the Kellogg Graduate School of Management of Northwestern University, is a Fellow in the American College of Commercial Finance Lawyers and is a member of the Advisory Board to the Duke Global Capital Markets Center. Jason has been chosen by *Chambers* as one of the top 100 internationally prominent lawyers and one of the top securitization lawyers in New York City and by Euromoney Legal Media Group as one of the "Best of the Best" in Structured Finance for the US. He has also been listed in *Euromoney's Guides to the World's Leading Capital Markets Lawyers*. Chambers quotes industry observers as saying that "His academic and practical contribution to the field is outstanding," that he "wrote the book on securitization, literally" and "has played a pivotal role in many regulatory initiatives." Jason is listed as a "pre-eminent securitization lawyer" (*Chambers Global Guide*), and has been called a "landmark of the industry" (*Chambers USA* 2006) and "Jason Kravitt, who 'wrote the bible on securitization" (*Chambers USA* 2009). "A leader in the securitization field for many years" (*Chambers USA* 2012). "An incredible legal strategist and a fantastic leader" (*Chambers USA* 2010) "Absolutely the number one lawyer in securitization" (*Legal 500 USA* 2009). "Commended for 'industry and regulatory knowledge, strength of counsel, and accuracy in prediction" (*Legal 500 USA* 2010). Jason was chosen by *Financial Times* as one of the 10 most innovative lawyers in America in 2010 and as the best lawyer in securitization in NYC by "Best Lawyers 2012 Lawyers of the Year."

Jason often represents industry groups such as large issuers of Asset-Backed Securities, sponsors of ABCP Conduits, SIFMA, the American Securitization Forum and the European Securitization Forum with regard to securitization regulatory initiatives, including, for example, the Basel Committee on Banking Supervision's Risk-Based Capital Consultative Papers, the F.F.I.E.C.'s Risk Based Capital projects, the F.A.S.B.'s Standards for Securitization, the F.A.S.B.'s Standard for Consolidation for SPEs, the SEC amendments to Rule 2a 7 and the SEC's Regulation AB, and often helps to lead initiatives in the securitization industry during times of market or other stress. Jason is also one of the three founders and the former Deputy Chair of the US Securitization Industry's premier trade association, the American Securitization Forum, and is a founder and the sole original member still serving on the Board of Directors of the European Securitization Forum.

Jason has helped the firm's clients to create some of the most significant securitization products used in the capital markets today, including the first partially enhanced multi-seller asset-backed commercial paper vehicle, in 1989, the first CLO, FRENDS, in 1988, and the Mortgage Partnership Finance Program for the Federal Home Loan Banks. He has worked for clients such as ABN, Ally Bank, Bank of America, Bank of New York Mellon, Barclay's Capital, BNP/Paribas, Calyon, CIBC, Citigroup, Commonwealth Bank of Australia, Credit Suisse, Deutsche Bank, EMI, GECC, GMAC, Goldman Sachs, HSBC, JP Morgan, Lehman Bros., Merrill Lynch, Morgan Stanley, PNC, Royal Bank of Canada, Societe Generale, UBS, Wachovia, Westpac, and similar banks and issuers throughout his career. Most recently, Jason was hired by the (i) Sponsoring Banks (Bank of America, Citigroup and JP Morgan) of the Master Liquidity Enhancement Conduit to help lead the structuring of that vehicle, designed to be a $100 billion rescue of the SIV industry and (ii) Citigroup and Morgan Stanley to help lead the structuring of Straight-A Funding LLC, the $60 billion conduit to help rescue the financing of Student Loans. He is also often hired to help financial institutions deal with serious regulatory issues or government investigations or to settle major litigation or potential litigation such as the Bank of New York Mellon's record-setting $8.5 billion settlement with Bank of America concerning 530 Countrywide RMBS trusts.

Jason has also served as Chairman of The Cameron Kravitt Foundation, a member of the Board of Managers of the Metropolitan Chicago YMCA, and a principal of Chicago United.

A Phi Beta Kappa graduate of The Johns Hopkins University in 1969 (where he has been Chairman of the Advisory Board to the Dean of the Krieger School of Arts & Sciences), Jason obtained his J.D. cum laude from Harvard Law School in 1972 and received a diploma in comparative law from Cambridge University in 1973.

Experience

- Creation of Straight-A Funding, LLC, a $60 billion asset-backed commercial paper conduit to finance the student loan industry with support from the Department of Education and the Federal Financing Bank.
- Creation of the form customer agreement documentation for the TALF program (and representing many of the primary dealers in their customer agreement negotiations) and several of the first TALF transactions.
- Represented industry groups such as large issuers of asset-backed securities, sponsors of ABCP Conduits, the Securities Industry and Financial Markets Association (SIFMA), and the European Securitization Forum with regard to securitization regulatory initiatives, including, for example, the Basel Committee on Banking Supervision's Risk-Based Capital Consultative Papers, the

FFIEC's Risk-Based Capital projects, the FASB's new Standards for Securitization, SFAS #125 and #140, the FASB's Standard for Consolidation, Fin 46R, and SEC Amendments to Rule 2a-7 and Reg AB.

- Served as one of the organizers and senior officers of the securitization industry's trade association, the American Securitization Forum.
- Represented the Sponsoring Banks in structuring the $100 Billion SIV rescue vehicle, Master Liquidity Enhancement Conduit.
- Helped to create some of the most significant securitization products used in the capital markets today, including the first partially enhanced, multi-seller, asset-backed commercial paper vehicle in 1989 and the first CLO, FRENDS in 1988.

Education

- University of Cambridge, 1973; Diploma, Comparative Law
- Harvard Law School, JD, cum laude, 1972
- The Johns Hopkins University, AB, 1969; Phi Beta Kappa

Admissions

- New York, 2002
- Illinois, 1974
- US Court of Appeals for the Seventh Circuit, 1974

Activities

- The Johns Hopkins University Alumni Advisory Council, 1991-1997, Advisory Board to the Dean of the School of Arts & Sciences, 1999 to 2009; Chair 2006-2007
- Chairman, The Johns Hopkins University Illinois Alumni Executive Committee, 1990-1994
- Director and Chairman, The Cameron Kravitt Foundation, 1985 to date
- Board of Managers, YMCA of Metropolitan Chicago, 1999-2001
- Principal, Chicago United, 1997-2001
- Deputy Chair, American Securitization Forum
- Director, European Securitization Forum
- Committee on Business Financing; Vice Chair Subcommittee on Securitization Litigation, American Bar Association,
- Chicago Bar Association Committees on Financial Institutions and Commercial Transactions
- Chicago Council of Lawyers
- Subcommittee on Securitization, New York City Bar Association
- Adjunct Professor of Law, Northwestern University School of Law
- Adjunct Professor of Finance, Kellogg Graduate School of Management of Northwestern University
- Fellow, American College of Commercial Finance Lawyers
- Advisory Board, The Financier and The Securitization Conduit, 1996 to date
- Advisory Board of The Securitization Conduit Publications
- Advisory Board, American Securitization
- Advisory Board, Duke University Capital Markets Center

News & Publications

- "Q&A: Jason Kravitt on securitization and frequent flying," *Thomson Reuters News & Insight*, 16 May 2013
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- "A Peek at the Future of the FDIC Securitization Safe Harbor," *Mayer Brown Legal Update*, 21 December 2009
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- "Securitization of Project Finance Loans and Other Private Sector Infrastructure Loans," *The Financier*, February 1994
- "How Feasible Is the Securitization of Loans to Small and Medium-Sized Businesses," *Commercial Lending Review*, Fall 1993
- "Full Service Brokerage Activities and the Glass-Steagall Act," *The Review of Financial Services Regulation, Vol. 4, No. 7*, 6 April 1988
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Alex Lakatos is partner in the Washington, DC office of Mayer Brown's Litigation and Financial Services Regulatory and Enforcement practices. Alex practices in complex international litigation, particularly on behalf of non-US financial institutions. He also counsels financial institutions on banking and securities regulatory, enforcement, legislative, and strategic issues. He has significant experience in matters where these areas intersect – for example, the litigation of cross-border disputes in US court in tandem with an SEC, OFAC or bank enforcement investigation. His matters often include parallel litigation in non-US forums. He is experienced in contesting issues of particular concern to non-US financial institutions, such as financial privacy, data protection, multi-jurisdictional discovery, choice-of-law conflicts, sanctions compliance and asset forfeiture.

In addition, Alex advises clients on avoiding litigation and provides related regulatory advice in areas such as the USA Patriot Act, the Bank Secrecy Act, the Unlawful Internet Gambling Enforcement Act, anti-money laundering compliance, and OFAC sanctions. He frequently has assisted clients with internal investigations, particularly related to the aforementioned areas. He has represented clients as both plaintiffs and defendants, in state and federal courts throughout the country and abroad, in class actions and other controversies, on issues including securities fraud, breach of fiduciary duty, breach of contract, civil RICO, the Anti-Terrorism Act, federal jurisdiction and venue.

Alex was recognized in the 2013 "Client Service All-Stars" report by BTI Consulting Group. BTI commended its winners for their "commitment to client service and ability to surpass the needs and expectations of the worlds most demanding clients" and lauded them for "standing above all others in the eyes of their clients." Alex is also recommended by *Legal 500* and noted as an "'excellent communicator' who specialises in advising foreign financial institutions in enforcement actions and litigation."

Alex is co-chair of the firm's Pro Bono Committee.

Experience

- Represented a Latin American bank: (1) in an internal investigation concerning whether the bank's relationship with a former head of state violated US anti-money laundering laws; (2) in the successful defense of a related suit against the bank alleging civil RICO and fraudulent conveyance claims; (3) as plaintiff in a civil RICO action against the head of state's agent; and (4) as plaintiff in a successful action against a US bank based on related asset transfers to the Latin American bank.

- Represented a European bank that was a victim of a multimillion-dollar investment company fraud, bringing actions against the perpetrators in Utah, Switzerland, Spain, and Gibraltar, defending a countersuit in the British Virgin Islands, and ultimately freezing and recovering substantial amounts for the bank.
- Represented a Swiss bank in connection with an action brought by a liquidating trust for a bankrupt corporation alleging that the bank aided and abetted breaches of fiduciary duty by the bankrupt corporation’s officers and violated Swiss law by engaging in transactions with the proceeds of the officers’ securities fraud. Obtained dismissal on forum non conveniens grounds.
- Represented a Swiss cement company as a defendant in a class action alleging that it had violated the Alien Tort Claims Act (ATCA) by aiding and abetting South African apartheid; the district court dismissed the case for lack of subject matter jurisdiction under the ATCA and a divided panel of the Second Circuit reversed. Khulumani v. Barclay Nat’l Bank Ltd. (2d Cir. 2007). Now seeking Supreme Court review.
- Represented major trade associations whose members include leading non-US banks and businesses in filing amicus briefs opposing extra-territorial application of US securities laws. Morrison v. National Australia Bank (2010); Viking Global Equities v. Porsche (2d Cir. 2011).
- Represented major US bank in opposing claims against the bank for negligence and aiding and abetting liability based on allegations that bank’s customers were involved in a multi-million dollar Ponzi scheme. Prevailed on motion to dismiss and on appeal in Wisconsin state courts.

Education

- University of California, Hastings College of the Law, JD, Valedictorian, 1995
- University of Maryland, BA, 1992

Admissions

- District of Columbia, 1997
- California, 1996
- US Supreme Court, 2007
- US District Court for the District of Columbia, 2006
- US Court of Appeals for the Ninth Circuit, 1997

Activities

- Board Member, Washington Lawyers Committee for Civil Rights and Urban Affairs, 2009 to present
- Project HOPE International, 2006 Partner of HOPE, for leadership in the provision of pro bono legal support in efforts to fight human trafficking
- American Bar Association

News & Publications

- "US Supreme Court Holds that the Alien Tort Statute Does Not Apply Extraterritorially," *Mayer Brown Legal Update*, 18 April 2013
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- "International Arbitration Perspectives - Winter 2009/2010," *Mayer Brown Newsletter*, 19 January 2010
- "Protecting Against WMD Proliferators," *Los Angeles Daily Journal*, 18 November 2009
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- "The Extraterritorial Reach of U.S. Anti-Terrorist Finance Laws," 2 March 2009
- "Anti-Suit Injunctions in Defence of Arbitration: Protecting the Right to Arbitrate in Common and Civil Law Jurisdictions (Part II)," 3 March 2008
- "Anti-Suit Injunctions in Defence of Arbitration: Protecting the Right to Arbitrate in Common and Civil Law Jurisdictions," *Bloomberg European Law Journal*, February 2008
- "Confidentiality of Suspicious Activity Reports," 15 October 2007
- "Internet Gambling CLE Presentation," 17 March 2007

- "Evaluating the Rules of Procedure and Evidence for the International Tribunal in the Former Yugoslavia: Balancing Witnesses' Needs Against Defendants' Rights," *Hastings L.J.*, 1995

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- "Anti-Money Laundering / OFAC / Cross-Border Hot Topics," In-House Presentation for Major Domestic Bank, Charlotte, 8 November 2010
- "The Opaque World of International Transparency: Global AML, Sanctions Compliance, and Strategic Options," BAFT-IFSA's 2010 Risk & Regulatory Symposium, Panel Presentation with Mike Bonafide, Tom Delaney and Simeon M. Kriesberg, 5 March 2010
- The Long Arm of US Sanctions: Implications for US and Foreign Banks, 8 October 2009
- "Litigation Invasion? The Reach and Influence of US Class Actions in Europe," Mayer Brown's London Seminar Series, 14 January 2008
- "Internet Gambling CLE Presentation," Lehman Brothers, New York, 13 March 2007

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"Recognized for his 'responsiveness, accessibility and outstanding service.'" Chambers USA 2009

Stuart M. Litwin is a partner and co-head of the Global Finance Practice at Mayer Brown. Stuart also co-heads Mayer Brown's Structured Finance and Capital Markets Practices.

Stuart is one of the leading lawyers in the United States in the representation of originators, investment banks, ABCP conduit sponsors, hedge funds, commercial banks and investors (including mutual funds) in structuring, negotiating and documenting US and international asset-backed and other securities transactions. His experience has involved the securitization of virtually all asset types, and he is recognized as an expert in the securitization and financing of retail and commercial auto loans and leases, FFELP and private student loans, dealer floorplan receivables, equipment leases and loans, rental cars, commercial and residential mortgages, cross border transactions, synthetic risk transfers, money market fund investments and structured transactions in which banks and other clients seek advantageous treatment for accounting, regulatory capital or tax purposes. Stuart also regularly represents several hedge funds and reinsurance companies in their "alternative investments" (i.e., unusual assets or finance companies discovered by the hedge fund which are more difficult to fund in securitization or banking markets). He also has substantial experience representing lessees, equity investors and debt investors in leveraged and synthetic lease transactions and M&A transactions involving banks and finance companies.

Recent important engagements have included (1) the creation of Straight-A Funding, LLC, a $60 billion asset-backed commercial paper conduit to finance the student loan industry with support from the Department of Education and the Federal Financing Bank; (2) the creation of the form customer agreement documentation for the TALF program (and representing many of the primary dealers in their customer agreement negotiations), and working on several of the first TALF transactions; (3) several tender offers for and restructurings of student loan trusts with auction rate securities; (4) the first ABS offering in the US backed by Australian auto leases; (5) representing Goldman, Sachs & Co. in the financing of Cerberus' acquisition of Chrysler, the largest-ever use of asset-backed securities in any M&A transaction ($47 billion of the $60 billion financing); and (6) representation of a heavy equipment manufacturer in the securitization of its floorplan loans to dealers in "politically sensitive" countries in Latin America.

Stuart represents virtually every major bank and investment bank in at least some aspect of its business. He also has been involved in some aspect of the financing programs of virtually every large auto finance company.

Chambers USA 2012 notes that Stuart is "highly recommended for his auto leasing experience and is said to 'know as much as anyone in that space.'" *Chambers USA* 2009 also lists Stuart as "one of the country's best and brightest for auto securitizations" and according to *Chambers Global* 2009, he is esteemed by clients for his "responsiveness, accessibility and outstanding service." *Legal 500 USA* 2009 noted that Stuart "has handled every variety of complex asset-backed products." He has also been ranked as one of the best securitization lawyers in the US by, among others, *Chambers Global, IFLR, Best Lawyers in America, Who's Who Legal* and *Euromoney*.

Stuart is a frequent lecturer and writer on securitization topics. The Structured Finance Institute has produced and sold a DVD*, Introduction to Securitization Transactions*, featuring Stuart. Among other publications, he is the author of the book *Equipment and Auto Lease Financing: Securitization, Leveraged Leasing and Titling Trusts* published by Aspen Law and Business and the Equipment and Auto Lease Securitization chapter of the *Equipment Leasing -- Leveraged Leasing Treatise* published by Practising Law Institute.

Education

- The University of Chicago Law School, JD, cum laude, 1985
- The University of Chicago, MBA, 1985
- University of Illinois, BS, summa cum laude, 1981; Bronze Tablet
- Certified Public Accountant (CPA), Illinois, 1981; Winner of Elijah Watt Sells Award on Uniform CPA Examination

Activities

- Adjunct Professor of Law, Northwestern University Law School
- Co-chair, Outside Counsel Sub-forum of the American Securitization Forum
- Chairman, Securities Law Committee, Chicago Bar Association, 1998–1999
- Chairman, Corporate Control Subcommittee, Chicago Bar Association, 1996–1998
- American Bar Association, Section of Corporation, Banking, and Business Law

News & Publications

- "CFTC Further Clarifies Commodity Pool Treatment for Certain Securitizations and Provides Additional No-Action Relief for Others," *Mayer Brown Legal Update*, 10 December 2012
- "Proposed Regulations Implementing the Volcker Rule," *Mayer Brown Legal Update*, 20 October 2011
- "Overview of the Proposed Credit Risk Retention Rules for Securitizations," *Mayer Brown White Paper*, 8 April 2011
- "US SEC Proposes Rules on ABS Warranty Repurchase Reporting," *Mayer Brown Legal Update*, 6 October 2010
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- "Summary of the US SEC's ABS Rule Change Proposal," *Mayer Brown Legal Update*, 21 April 2010
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- "Signs of life in the asset-backed world," *Source Media*, 10 December 2009
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Stephanie Monaco is a member of the Corporate & Securities practice. She advises investment management firms, investment companies and hedge funds across a broad range of investment management needs. Formerly an attorney with the US Securities and Exchange Commission, Stephanie brings a deep understanding of the regulatory environment to counseling clients on issues of compliance and product development.

Stephanie was named the Best Lawyers' 2012 Washington DC Private Funds / Hedge Funds Law Lawyer of the Year. She has been recognized in *Chambers* for her "great attitude, great business sense and responsiveness." *Chambers* has also noted that Stephanie "has a keen understanding of industry issues" and "knows when to step back and when an issue has to be forced."

Stephanie joined Mayer Brown in 2005. Previously, she was a partner at other prominent law firms in Washington, DC. She also worked with the SEC's Division of Investment Management, first in the Division's Chief Counsel's Office (1983–1986) and, later, in the Division's Office of Investment Company Regulation (1988–1991).

Education

- University of Baltimore School of Law, JD, 1982
- University of Maryland, BA, 1979

Admissions

- District of Columbia, 1992
- Maryland, 1982

News & Publications

- "US Commodity Futures Trading Commission Releases FAQs for CPOs and CTAs," *Mayer Brown Legal Update*, 22 August 2012
- "Second Circuit Court of Appeals Decision Highlights Potential Liability of Advisers to Related Investors in Securitizations," *Mayer Brown Legal Update*, 15 August 2012
- "'Net Worth' Standard for Accredited Investors Further Amended by US Securities and Exchange Commission," *Mayer Brown Legal Update*, 4 January 2012
- "Proposed Regulations Implementing the Volcker Rule," *Mayer Brown Legal Update*, 20 October 2011

- "Securities Investigations: Internal, Civil and Criminal," *Practising Law Institute*, August 2012
- "US Securities and Exchange Commission Adopts New Exemptions for Investment Advisers," *Mayer Brown Legal Update*, 15 July 2011
- "US Securities and Exchange Commission Proposes to Remove References to Credit Ratings from Certain Investment Company Act Rules and Forms," *Mayer Brown Legal Update*, 8 March 2011
- "SEC Adopts Amendments to its Investment Adviser Registration Form (Part 2 of Form ADV)," *Mayer Brown Legal Update*, 23 July 2010
- "US SEC Amends Custody Rule for Registered Investment Advisers," *Mayer Brown Legal Update*, 14 June 2010
- "SEC's new adviser exam schedule: 'We simply show up'," 9 April 2010
- "US SEC Adopts Amendments to Rule 2a-7 Affecting Money Market Funds," *Mayer Brown Legal Update*, 7 April 2010
- "What are the Proposals for Advisers Act Registration for Private Fund Advisers and What is the Status?," *Mayer Brown Legal Update*, 22 March 2010
- "US SEC Adopts Amendments to Regulation SHO," *Mayer Brown Legal Update*, 26 February 2010
- "Status of Advisers Act Registration for Private Fund Advisers," *Mayer Brown Legal Update*, 28 December 2009
- "US SEC Adopts Significant Changes to Custody Rule for Registered Investment Advisers," *Mayer Brown Legal Update*, 21 December 2009
- "Proposed US Legislation Requires Advisers of Private Investment Funds to Register with the SEC," *Mayer Brown Legal Update*, 3 September 2009
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- "US SEC Proposes Significant Changes to Custody Rule for Registered Investment Advisers," *Mayer Brown Legal Update*, 19 June 2009
- "US Securities and Exchange Commission Considers New Short Selling Regulation," *Mayer Brown Legal Update*, 15 April 2009
- "Operating a Hedge Fund in a Regulated Environment, The Review of Securities & Commodities Regulation — An Analysis of Current Laws and Regulations Affecting the Securities and Futures Industries," *The Review of Securities & Commodities Regulation*, 2002

Events

- The Continuing Impact of Dodd-Frank, 26 June 2013
- 7th Annual Investment Management Regulatory University, May 2013
- 6th Annual Investment Management Regulatory University - Chicago, 24 May 2012
- 6th Annual Investment Management Regulatory University - New York, 22 May 2012
- Dodd-Frank: One Year Later, 27 July 2011
- Asset Management Portfolio Transfers, 26 August 2010

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Joel Moss is a Restructuring, Bankruptcy & Insolvency partner in Mayer Brown's New York office. Prior to joining Mayer Brown, he was a director at Barclays in New York, where he handled bankruptcy and restructuring matters for the bank in the US. At Barclays, Joel was the primary lawyer responsible for a broad range of bankruptcy and restructuring matters as well as the bank's US resolution plan ("living will") required pursuant to the Dodd-Frank Act. His responsibilities included advising trading desks on bankruptcy issues relating to proposed and existing investments; reviewing and negotiating restructuring-related documentation for Barclays as agent in a number of distressed situations; negotiating and reviewing documentation for DIP financings in which Barclays was agent and lender; and advising various business units on bankruptcy risks relating to certain transactions. Joel has extensive experience in advising financial institutions on, among other things, the safe harbors applicable to financial contracts.

Education

- New York University School of Law, JD, magna cum laude, 2001; Order of the Coif; Seymour Goldstein Labor Law Prize
- Duke University, AB, magna cum laude, 1998

Admissions

- New York
- California (inactive)

News & Publications

- "*In re Fairfield Sentry Ltd.*: Second Circuit Court of Appeals Provides Guidance to "COMI" Determinations in Chapter 15 Cases," *Mayer Brown Legal Update*, 19 April 2013
- "Mayer Brown strengthens Restructuring, Bankruptcy & Insolvency practice in NY with addition of Joel Moss as partner," 12 March 2013
- "Expedited Restructurings in the US and Select Latin American Jurisdictions (with Richard Cooper and Adam Brenneman)," *Pratt's Journal of Bankruptcy Law*, November/December 2011
- "W.R. Grace: Unsecured Bank Lenders Are Not Entitled to Post-Petition Default Interest (with G. Alexander Bongartz)," *American Bankruptcy Institute Law Journal*, May 2011
- "Putting Section 363 Asset Sales to Work (with Lisa Schweitzer)," *International Financial Law Review: The 2010 Guide to Restructuring & Insolvency*, September 2010

- "Frenville: Finally Dead and Buried in the Third Circuit," *American Bankruptcy Institute Law Journal*, September 2010
- "Fiduciary Duties in Cross-Border Restructurings (with Martin N. Flics and Brian E. Greer)," *InsolWorld*, Third Quarter 2007
- "Guaranties in Bankruptcy: A Primer (with Brian E. Greer)," *Norton Journal of Bankruptcy Law and Practice*, July/August 2007
- "Subprime Shakeout: Efficient Market or Looming Crisis? (with Martin N. Flics and Brian E. Greer)," *Practicing Law Institute*, 24 May 2007
- "Distressed Cities See No Clear Path (with Gary M. Kaplan)," *National Law Journal*, 6 June 2006

Events

- The Continuing Impact of Dodd-Frank, 26 June 2013
- Foreign Banking Organizations, 19 June 2013

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Sources enthuse over Ed Parker's "encyclopaedic knowledge of all things ISDA. Whatever the transaction thrown at him, he knows the technical points inside out." Chambers UK 2013

Edmund Parker is head of the London office's Derivatives & Structured Products practice. He is also co-head of the firm's global Derivatives & Structured Products practice, heads the firm’s UK Capital Markets practice, and is a Co-practice leader of the Indian Practice Group.

He advises on complex OTC and structured credit, equity and commodity derivatives (including emissions trading), as well as insurance and pensions-linked derivative structures. He advises on distressed derivatives, together with our litigators and insolvency specialists; as well as advising on central clearing issues and derivatives regulation, together with our regulatory team. Ed has strong structured finance/debt issuance skills in particular in relation to CLOs and hybrid structures (see Experience).

Consistently ranked as a key individual by both *Chambers* and *Legal 500*, Ed ”is an authority on complex OTC derivatives, property and commodity derivatives” (*Chambers UK 2012*). His "encyclopaedic knowledge means he knows the technical points inside out" notes *Legal 500 2012*; he is "willing to go the extra mile and gives clear, commercially focused advice" (*2011*); he "offers excellent levels of service, he has done a great job pushing the practice to the forefront among London firms" (*2010*); he embodies its "fair, objective and rigorous approach" and “is well liked throughout the industry” (*2009*). *Chambers UK 2009* noted that he "would easily fit into any top-tier derivatives practice" and "has great expertise".

Ed has written extensively on derivatives matters (see News & Publications). He is the industry’s most widely published lawyer on the subject, with his views regularly sought by the press and on television. His written works include an acclaimed trilogy of derivatives books, consisting of, as sole author Credit Derivatives: Documenting and Understanding Credit Derivative Products, as sole editor Equity Derivatives: Documenting and Understanding Equity Derivative Products, and as co-editor Commodity Derivatives: Documenting and Understanding Commodity Derivative Products. He is currently co-writing a new book, Equity Derivatives: A Practitioner’s Guide to the 2002 & 2011 ISDA Equity Derivatives Definitions. Ed is fluent in Spanish.

Experience

- From 2008 to present, leading a UK/US team acting for Citigroup in relation to all credit events affecting corporate reference entities in its structured products portfolio including synthetic CDOs, repackaged notes, unfunded credit derivatives and CDO squared transactions. The project was recognised by Futures and Options (FOW) in 2010 as the market leader in distressed derivatives, winning their 'Most innovative work by a law firm in the field of exchanged-traded or centrally cleared derivatives' award'.
- Advising French investment bank in establishing a USD$ 700 million collateral protection arrangement to secure indirect derivative exposure across multiple CLO structures via the back to back swap arrangements with SPVs.
- Acting for German Landesbank in USD 440 million fiduciary note combined issuance, with embedded repo structure.
- Advising UBS in relation to a USD $380 million dispute arising out of a series of credit default swap and synthetic CDO transaction with the city of Leipzig Water Board, Kommunale Wasserwerke Leipzig GmbH (or KWL).
- Advising Swiss bank on structuring and documenting a GBP 180 million longevity swap transaction referencing an index of life assurance policies, which themselves collateralised the transaction. The instruction required expertise in US insurance regulation, English and New York law security, English law derivatives, and English law insurance.
- Establishment of innovative Commodity Derivatives Metals Leasing Documentation Platform for use across multiple jurisdictions for UK investment bank.
- Advising on a series of life settlement derivatives transactions for Japanese bank.
- Advising KPMG as administrator of Lehman Brothers Commercial Corporation Asia Limited (Lehman Brothers Asian Operation) on derivatives matters as part of cross-juridisdictional/practice team from 2008 to present.
- As part of India Practice Group, advising the UK subsidiary of Indian Gulf Oil Corporation Ltd (GOCL), the India based lubricants division of the international conglomerate the Hinduja Group, on its purchase of US industrial fluids manufacturer Houghton International Inc for $1.045 billion, the largest outbound acquisition by an Indian company in 2013.

Education

- The College of Law, London, 1996; Legal Practice Course
- Queen Mary, University of London, 1995; LLM, International Business Law
- Dundee University, 1994; LLB, (Hons)

Admissions

- England and Wales, 1999

Activities

- Granted the Freedom of the Worshipful Company of Solicitors of the City of London
- Granted the Freedom of the City of London

- Member of PLC Finance (Practical Law Company) consultation board. Practical Law Company (PLC) is the leading provider of legal know-how, transactional analysis and market intelligence for lawyers. The consultation board comprises leading experts in Finance and related areas. They help to shape the service and are consulted on complex areas of law and emerging practice. Visit: http://finance.practicallaw.com/6-201-8986
- Liveryman of the Worshipful Company of Solicitors of the City of London

News & Publications

- "Isda set to offer new CDS insurance policy," *Financial News*
  subscription required
  , 3 June 2013
- "The Company's Banquet at the Mansion House on Monday 18 March," *City Solicitor*, 23 May 2013
- "European Closing Bell Show," *CNBC*, 17 May 2013
- "Sovereign Debt and Debt Restructuring," Ed Parker, head of London's Derivatives & Structured Products practice, and senior Finance associate Marcin Perzanowski co-authored chapters on "Credit Derivatives and Sovereign Debt" and Credit derivatives and the sovereign debt restructuring process"., *Globe Law and Business*, April 2013
- "Reg cap clampdown plays to clearing mandate," *International Financing Review*, 20 March 2013
- "EMIR rules will catch many pension funds off-guard, law firm warns," *Investment & Pensions Europe*, 15 March 2013
- "Buyside struggle with EMIR deadline," *IFR*
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- "Mayer Brown advises Gulf Oil on $1.045 billion chemicals deal," 12 November 2012
- "Spanish swaps contracts raise concerns," *IFR*, 10 August 2012
- "Bail-in fuels CDS reform," *Reuters*, 15 June 2012
- "Time to tighten the net on CDS?," *Financial News*
  (subscription required), 21 May 2012
- "Derivatives desks prep for Greek exist," *IFR*, 21 May 2012
- "Traders resist calls to rewrite sovereign CDS documents," *Creditflux*, 1 May 2012
- "DERIVATIVES: Judgement vindicates ISDA contract, but changes needed," *IFR*, 4 April 2012
- "ISDA Master Agreement still needs tweaks," *Derivatives News*, 4 April 2012
- "Deutsche Börse's lawsuit and the banana market," *Financial News*, 26 March 2012
- "Lack of CDS compounds Greek bond pain," *Reuters*, 23 March 2012
- "Of plumbing and promises
  The back office moves centre stage," *The Economist*, 25 February 2012
- "Ministers step up fight to protect City from EU trading shake-up," *The Telegraph*, 14 February 2012
- "End of EU derivatives haggling sparks new concerns," *Reuters*, 10 February 2012
- "Derivatives Industry eyes UK Lehman appeal ruling," *Reuters*, 14 December 2011
- "Dexia succession event pondered," *IFR*
  (subscription required), 29 October 2011
- "Will they, won't they: Greek CDS trigger in question," *Reuters*, 26 October 2011
- "MiFID tightens position noose," *IFR*
  (subscription required), 9 September 2011

- "ISDA Determinations Committee under scrutiny," *IFR (subscription required)*, 5 August 2011
- "UK ETF clampdown reverberates through sector," *IFR (subscription required)*, 2 July 2011
- "France's Sarkozy demands crackdown on commodity speculators," *China Post*, 16 June 2011
- "Why Emir and Mifid proposals go too far," *IFLR (subscription required)*, 2 June 2011
- "European Parliament recognises FX issues," *FX Week (subscription required)*, 30 May 2011
- "Regulatory divide could 'paralyse some institutions'," *IFR (subscription required)*, 28 May 2011
- "What are CDS really worth?," *IFR (subscription required)*, 30 April 2011
- "Antitrust rumblings over index ownership," *Financial Times (subscription required)*, 27 April 2011
- "Pension funds make last stand to avert clearing," *Euromoney (subscription required)*, April 2011
- "QCC Roils Options Market," *Markets Media (subscription required)*, 22 March 2011
- "Derivatives Regulation: Outlook for 2011 in the United States and Europe," *Derivatives Week*, 17 January 2011
- "Practical Derivatives: A Transactional Approach, (2nd ed.)," *Globe Business Publishing*, November 2010
- "E.U. Derivative Reforms: The Shape of Things to Come," *Legal Week*, 14 October 2010
- "EU Derivatives Reform," *Derivatives Week*, 20 September 2010
- "Financial regulation: Basel's buttress," *The Economist*, 16 September 2010
- "Derivatives Regulation: European Glee or a New Era of Global Regulatory Harmony?," 28 July 2010
- "Equity Derivatives:Documenting and Understanding Equity Derivative Products," Commodity derivatives are financial instruments whose value is based on underlying commodities, such as oil, gas, metals, agricultural products and minerals. Other assets such as emissions trading credits, freight rates and even the weather can also underlie commodity derivatives. the publication examines the full spectrum of equity derivative transactions and their related documentation, as well as the regulatory and tax aspects of equity derivative products across key jurisdictions. Marcin Perzanowski as co-author of chapters on the "2002 ISDA Equity Derivatives Definitions"; "The ISDA Suite of Equity Derivatives Documentation", and "Underlying Equity Derivative Assets." The book has received numerous reviews, including the following from Dean Kloner, Futures & Derivatives Law Report "The book serves both as an excellent text book for those that wish to learn about equity derivatives, as well as an excellent reference source for more experienced practitioners, and is therefore highly recommended .", *Global Law and Business*, July 2010
- "OTC Derivatives Regulation in 2010: What is it and what does it mean for Companies?," March 2010
- "S&P and Fitch Announce Special Designations for Structured Finance Ratings," *Mayer Brown Legal Update*, 23 February 2010
- "2010: The Biggest Year in Derivatives Regulation Since 1733," *Mayer Brown*, 21 January 2010
- "Derivatives: their role in loan transactions," 13 January 2010
- "Cracks are emerging in transatlantic approach to reform," *Financial Times*, 6 January 2010

- "Securitization of Financial Assets," *Aspen Law & Business (3rd ed.)*, 2010
- "Regulating Derivatives: What's in Store for Europe and the US in 2010?," *Derivatives Week*, 28 December 2009
- "Mayer Brown advised SoFFin on the establishment of the first "bad bank" in Germany," 15 December 2009
- "Default swap reforms roiled as Aiful tests settlement," *Bloomberg*, 27 November 2009
- "Clearing – who decides?," *Financial Times*, 16 November 2009
- "Commodity Derivatives: Documenting and Understanding Commodity Derivative Products," *Globe Law & Business*, August 2010
- "Regulation of credit rating agencies in Europe," *Journal of International Banking & Financial Law*, August 2009
- "Proposed Reform of the OTC Derivatives Market: Turning "Weapons" into Plowshares," *The Journal of Structured Finance*, Summer 2009
- "EU Regulation of Credit Rating Agencies in Europe," 24 April 2009
- "The ISDA Master Agreement and CSA: Close-out Weaknesses Exposed in the Banking Crisis and Suggestions for Change," *Butterworths Journal of International Banking Law*, January 2009
- "Constant proportion debt obligations: what went wrong and what is the future for leveraged credit?," 30 November 2008
- "Mayer Brown Is Representing CIBC in $1.05 Billion Deal With Cerberus," 3 October 2008
- "Credit Derivatives: Documenting and Understanding Credit Derivative Products, 2007," October 2007
- "The 2003 ISDA Credit Derivatives Definitions," 6 March 2008
- "Practice Note: Credit Derivatives," February 2008
- "Credit Derivative Product Companies - A Primer," 28 January 2008
- "Mayer Brown is named "Securitisation Law Firm of the Year 2007" at the Global Derivatives and Securitisation Awards," 7 December 2007
- "Green Structured Products are Likely to Proliferate," *Mayer Brown*, 3 December 2007
- "Fair Wind for Eco ABS," June 2007
- "Anti-risk list: An Article on Using Derivatives to Manage the Deficits in Defined Benefit Pension Schemes," *The Lawyer*, 7 May 2007
- "Documenting credit default swaps on asset backed securities," 19 April 2007
- "Property derivatives documents due," 14 April 2007
- "Environmental ABS beckons," June 2007
- "Derivatives Uncovered: Swaps, Futures and all that Jazz," *PLC Magazine*, October 2005
- "Practice Note: 2003 ISDA Credit Derivatives Definitions," *PLC Magazine*, February 2008
- "ISDA's 2007 Property Index Derivatives Definitions: A Killer Application for the Property Index Derivatives Market?," *Real Estate Legal Alert*, May 2007

Events

- The Continuing Impact of Dodd-Frank, 26 June 2013
- The Continuing Impact of Dodd Frank, 26 June 2012
- Insurance and Reinsurance Legal Developments: Financial Convergence & Global Regulatory Updates, 17 April 2012
- Greek Sovereign Default: What Happens Next?, 18 May 2010
- Panel Discussion on Derivatives Regulation, 8 March 2010
- OTC Derivatives Market: An Update on Transatlantic Reform, 12 November 2009

- Proposed Reform of the OTC Derivatives Market: The Transatlantic Perspective, 17 September 2009

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Jerome Roche is a Financial Services Regulatory & Enforcement partner in Mayer Brown's Washington DC office. His practice focuses primarily on cross-border financial services matters. He has extensive experience counseling clients regarding the US federal securities laws, the Commodity Exchange Act, the Commodity Futures Modernization Act, the Gramm-Leach-Bliley Act, the USA PATRIOT Act, and the Dodd-Frank Act. According to *Chambers USA* 2012, Jerome is considered by clients to be "a very strong counselor who brings a highly pragmatic approach to complex issues." He also received a *Martindale-Hubbell* peer review rating of AV-Preeminent in 2012 and 2013.

Experience

- Addressing regulatory status questions for US and non-US financial institutions effecting transactions in, and providing advice with respect to, securities, commodities, foreign currency and derivatives;
- Drafting and implementing supervisory and compliance policies and procedures for regulated financial institutions;
- Counseling customers and other counterparties of US broker-dealers regarding customer protection rules, broker-dealer insolvencies, and the Securities Investor Protection Act;
- Seeking required approvals for mergers, acquisitions and restructurings of regulated financial institutions; and
- Guiding financial institutions and trade associations in complying with, and commenting on, rule-making efforts of the Securities and Exchange Commission, the Commodity Futures Trading Commission, Financial Industry Regulatory Authority, the National Futures Association, and other self-regulatory organizations.

Education

- Purdue University, BS, 1992
- The University of Michigan Law School, JD, 1997

Admissions

- Illinois, 1997
- District of Columbia, 2000

Activities

- National Hispanic Bar Association

News & Publications

- "CFTC Issues a Final, Time-Limited Exemptive Order and Proposes Further Guidance Regarding Cross-Border Regulation of Swaps," *Mayer Brown Legal Update*, 31 December 2012
- "CFTC's January 1 Business Conduct and Documentation Deadline Eased," *Mayer Brown Legal Update*, 18 December 2012
- "US Secretary of the Treasury Exempts FX Swaps and Forwards from Certain Requirements Under the US Commodity Exchange Act," *Mayer Brown Legal Update*, 20 November 2012
- "US Commodity Futures Trading Commission Releases FAQs for CPOs and CTAs," *Mayer Brown Legal Update*, 22 August 2012
- "Sure, My Project Has Swaps (In Fact, My Lenders Required These Hedges), But Why Does That Make It A Commodity Pool and Why Am I Now A Commodity Pool Operator?," *Mayer Brown Legal Update*, 15 August 2012
- "CFTC Proposes Phased Compliance Program for Certain Swaps," *Mayer Brown Legal Update*, 6 July 2012
- "Proposed CFTC Guidance Regarding the Cross-Border Application of US Swap Regulations," *Mayer Brown Legal Update*, 2 July 2012
- "The New CFTC and SEC Swap "Entity" Definitions—Highlights," *Mayer Brown Legal Update*, 30 April 2012
- "'Net Worth' Standard for Accredited Investors Further Amended by US Securities and Exchange Commission," *Mayer Brown Legal Update*, 4 January 2012
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- "US Securities and Exchange Commission Adopts New Exemptions for Investment Advisers," *Mayer Brown Legal Update*, 15 July 2011
- "Financial Reform and Securitization," *Mayer Brown Legal Update*, 15 July 2010
- "US SEC Amends Custody Rule for Registered Investment Advisers," *Mayer Brown Legal Update*, 14 June 2010
- "Foreign Account Tax Compliance Act of 2009," *Mayer Brown Legal Update*, 20 April 2010
- "US SEC Adopts Amendments to Regulation SHO," *Mayer Brown Legal Update*, 26 February 2010
- "US SEC Adopts Significant Changes to Custody Rule for Registered Investment Advisers," *Mayer Brown Legal Update*, 21 December 2009
- "OTC Derivatives—In the Crosshairs of US Legislative and Regulatory Change Part III: An Update," *Mayer Brown Legal Update*, 1 September 2009
- "US SEC Again Revisits the Regulation of Short Sales," *Mayer Brown Legal Update*, 18 August 2009
- "US SEC Takes Additional Action to Address Short Sales," *Mayer Brown Legal Update*, 29 July 2009
- "US SEC Proposes Significant Changes to Custody Rule for Registered Investment Advisers," *Mayer Brown Legal Update*, 19 June 2009

- "US Securities and Exchange Commission Considers New Short Selling Regulation," *Mayer Brown Legal Update*, 15 April 2009
- "International Financial Law Review ranks 20 Mayer Brown lawyers; 21 practices in IFLR1000," 6 November 2008
- "Regulation R: The Beginning of the End or the End of the Beginning for Bank Brokerage Activities?," *NC Banking Institute Journal*, Spring 2008
- "Mayer, Brown, Rowe & Maw Adds New Financial Services Partner," 22 March 2007
- "Broker-Dealer 101: An Introduction to the Law and Lore of Securities Brokers and Dealers," *The Investment Lawyer*, 1 July 2003
- "New Contours of Bank Securities Activities: The “Dealer” Push-Out Rules," *The Banking Law Journal*, May 2003
- "Safe Harbour for Swaps," *UK Risk and Reward*, December 2001
- "Broker-Dealer Regulation," *Practising Law Institute*,

Events

- The Continuing Impact of Dodd-Frank, 26 June 2013
- SEC Proposes Rules on Cross-Border Security-Based Swaps Transactions, 6 June 2013
- 7th Annual Investment Management Regulatory University, May 2013
- "Insurance vs. Swaps Under Dodd-Frank," Mayer Brown Global Financial Markets Initiative Teleconference Series, 2 August 2012
- The Continuing Impact of Dodd Frank, 26 June 2012
- Lehman Bankruptcy and Client Monies, 10 May 2012
- Implementation of the Dodd-Frank Act – Implications for Internationally Headquartered Banking Organizations: Part 2: Implementation of Other Key Provisions of Dodd-Frank for International Banks, 12 April 2011
- "Tax and Securities Law Issues Associated with Serving US Clients," Presented at the OffshoreAlert Conference in Miami, April 2011
- Understanding the New Financial Reform Legislation, 12 July 2010
- US Equity Market Structure, June 2010
- "Broker-Dealer Fundamentals," Mayer Brown Investment Management and Regulatory University (May 2010, May 2009 and May 2008), 1 May 2010
- Managing the Risks in Serving US Clients: What Every Non-US Financial Institution Needs to Know in Today's Environment, 21 October 2009
- "Short Selling: Upticks, Down-Bids and Circuit Breakers? Now What?," Presented as a webinar with Eric Finseth on behalf of the Practising Law Institute, October 2009
- Bloomberg TV, September 2008
- "Short Selling: Has it Been Stopped Short? Now What?," Presented as a webinar with Eric Finseth on behalf of the Practising Law Institute, October 2008
- " Dealer Overview," Presented at the ALI-ABA Broker-Dealer Conference, January 2005
- "Regulation of Broker-Dealers," Presented as part of the DC Bar CLE Program, March 2003

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David Sahr advises domestic and foreign financial institutions on establishing and expanding their operations in the United States as well as on related regulatory, enforcement and compliance matters. He represents banks and their affiliates before federal and state agencies, including the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Securities and Exchange Commission. He assists financial institutions in the development and sale of new products including compliance with state and federal banking, securities and commodities laws. David also advises and represents foreign banks on federal legislative developments affecting their US banking and non-banking operations.

David has worked closely with banks and trade associations on the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). He has advised numerous clients on their response to the regulatory implementation of Dodd-Frank, including drafting comment letters on new capital rules, the Volcker Rule and new derivatives regulations.

David is also advising several foreign and US banks on their implementation of the full gamut of the requirements of Dodd-Frank. For example, he has provided in depth advice with respect to the prohibition on proprietary trading and on sponsorship of and investment in covered funds by banking entities (the Volcker Rule) and the regulation of OTC derivatives. *Chambers USA 2011* noted David's work "advising a number of foreign lenders and other financial services entities on Dodd-Frank compliance, " and according to *Chambers USA 2012*, "[h]e is widely admired by peers and clients alike, who highlight him as being 'very responsive and extremely well informed.'"

Experience

- Represented a foreign bank in the establishment of a US bank subsidiary including obtaining regulatory approvals from the chartering authority, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System.
- Represented a foreign bank in acquiring a US energy trader including obtaining approval of the Board of Governors of the Federal Reserve System for authority to engage in activities that are "complementary" to activities that are financial in nature.
- Represented a foreign bank in complying with banking, securities and other laws in connection with the development and sale of complex financial products and structures.
- Represented foreign and domestic banks in complying with Bank Secrecy Act requirements and in responding to enforcement actions brought by federal banking agencies.
- Represented several foreign banks in establishing branches, agencies and representative offices in the United States.

Education

- Georgetown University, BS, magna cum laude, 1976
- The London School of Economics and Political Science, MS, 1977
- Georgetown University Law Center, JD, magna cum laude, 1982

Admissions

- District of Columbia, 1982

News & Publications

- "Mayer Brown represents CIMC on inaugural $600 million letter of credit backed US commercial paper program," 28 January 2013
- "CFTC Issues a Final, Time-Limited Exemptive Order and Proposes Further Guidance Regarding Cross-Border Regulation of Swaps," *Mayer Brown Legal Update*, 31 December 2012
- "Federal Reserve Proposes Enhanced Prudential Standards for Non-US Banking Organizations," *Mayer Brown Legal Update*, 20 December 2012
- "CFTC's January 1 Business Conduct and Documentation Deadline Eased," *Mayer Brown Legal Update*, 18 December 2012
- "US Secretary of the Treasury Exempts FX Swaps and Forwards from Certain Requirements Under the US Commodity Exchange Act," *Mayer Brown Legal Update*, 20 November 2012
- "CFTC Proposes Phased Compliance Program for Certain Swaps," *Mayer Brown Legal Update*, 6 July 2012
- "Proposed CFTC Guidance Regarding the Cross-Border Application of US Swap Regulations," *Mayer Brown Legal Update*, 2 July 2012
- "CFTC Skips `Intergalactic' Power in Dodd-Frank Guidance," *Bloomberg*, 29 June 2012
- "The New CFTC and SEC Swap "Entity" Definitions—Highlights," *Mayer Brown Legal Update*, 30 April 2012
- "Proposed Regulations Implementing the Volcker Rule," *Mayer Brown Legal Update*, 20 October 2011
- "US Securities and Exchange Commission Adopts Large-Trader Reporting System," *Mayer Brown Legal Update*, 9 August 2011
- "Dodd-Frank Title VII (Swaps) Effectiveness—July 16 and Beyond," *Mayer Brown Legal Update*, 14 June 2011
- "US FDIC and Federal Reserve Propose Rule on Resolution Plans and Credit Exposure Reports," *Mayer Brown Legal Update*, 2 May 2011
- "US Treasury to Impose Requirement on US Correspondent Banks to Obtain Iran-Related Information from Foreign Banks," *Mayer Brown Legal Update*, 29 April 2011
- "Comments Requested on Proposed "Key Definitions" of the Wall Street Transparency and Accountability Act," *Mayer Brown Legal Update*, 23 August 2010
- "Financial Reform and Securitization," *Mayer Brown Legal Update*, 15 July 2010
- "The Volcker Rule: Proprietary Trading and Private Fund Restrictions," *Mayer Brown Legal Update*, 30 June 2010
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- The Implications of the Volcker Rule, 17 June 2010

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Jeffrey Taft is a regulatory attorney whose practice focuses primarily on banking regulations, bank receivership and insolvency issues, payment systems, consumer financial services, privacy issues and anti-money laundering laws. He has extensive experience counseling financial institutions, merchants and other entities on various federal and state consumer credit issues, including compliance with the Consumer Financial Protection Act, Truth-in-Lending Act, the Fair Credit Reporting Act, the Electronic Fund Transfer Act, the Equal Credit Opportunity Act, the Fair Debt Collection Practices Act, the Real Estate Settlement Procedures Act, state and federal unfair or deceptive practices statutes, the Bank Secrecy Act, the USA PATRIOT Act, OFAC regulations and other anti-money laundering laws; and the creation and implementation of privacy and information security programs under Title V of the Gramm-Leach Bliley Act and state privacy laws.

Jeff regularly represents banks, bank holding companies, trust companies and other financial service providers on regulatory matters, including the development and operation of multi-state fiduciary, deposit and credit card programs. He has also advised merchants and financial services companies on issues relating to credit cards, debit cards, gift cards, wire and ACH transfers and other payment products.

Prior to joining the Washington, DC office of Mayer Brown in 1998, Jeff held a senior position with a prominent Ohio law firm.

Experience

- Advised various bank and non-bank clients regarding regulation, supervision and examination of consumer financial services activities by the CFPB and the federal banking agencies.
- Advised clients regarding bank insolvency issues and the Dodd-Frank Act’s Orderly Liquidation Authority.
- Advised numerous companies in connection with data security breaches involving customer or employee information and their security breach response plans and procedures.
- Advised investment funds and other secondary market purchasers on federal, state and local consumer lending laws, licensing requirements and assignee liability.
- Advised mobile payment provider in connection with its federal and state consumer credit compliance program.

Education

- Tulane University, BA, 1989

- University of Pittsburgh School of Law, JD, cum laude, 1992
- Harvard Law School, LLM, 1993

Admissions

- District of Columbia, 2001
- Ohio, 1994
- New York, 1993

Activities

- Governing Committee Member, Conference on Consumer Finance Law
- Fellow, American College of Consumer Financial Services Lawyers
- American Bar Association: Business Law Section, Cyberspace Law, Banking Law and Consumer Financial Services subcommittees
- New York State Bar Association: Business Law Section

News & Publications

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- "Lessons From ChoicePoint and Lexis-Nexis," Stafford Publishing Teleseminar, August 2005
- "Unfair or Deceptive Practices in the Sales, Marketing and Servicing of Consumer Financial Services and Products," UNC School of Law Festival of Legal Learning, February 2005

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"A pleasure to work with and does excellent work." Chambers USA 2010

Jon Van Gorp is leader of our Chicago office’s Banking & Finance practice and co-leader of the firm’s Structured Finance and Capital Markets practices. Jon's experience includes public and private securities offerings, assets sales, structured finance transactions, leveraged leases, derivatives, synthetic risk transfer programs and financial insurance. He is highly skilled at finding ways to fund difficult-to-finance assets, such as nonperforming mortgage loans, distressed ABS and MBS, mortgage servicing rights and servicing advances, and he assists clients that wish to fund their operations, sell or acquire asset portfolios and businesses, or manage and hedge their exposures by buying and selling risk.

Jon is known as an innovator. He has been part of the legal team that completed many first-of-their-kind transactions, including the first auto leveraged lease transaction funded with asset-backed debt, the first synthetic transfer of risk related to a portfolio of consumer auto leases, the first issuance of bank debt guaranteed by Farmer Mac, the first auto receivables shelf registration statement to go effective under regulation AB, the first publicly offered CDO of mezzanine MBS debt and the first securitization of Mexican mortgage loans funded in the US capital markets. Jon's reputation for innovation was recognized by the *Financial Times*, which ranked a risk protection arrangement that he helped design as the second most innovative M&A transaction of 2010.

For several years Jon has been ranked as an outstanding lawyer by *Chambers USA*, *Chambers Global*, *Legal 500* and *IFLR 1000*.

- One client said approvingly: "We consider him a business partner and not just an outside counsel." (as noted in *Chambers USA* 2013)
- "Very thoughtful, creative and knowledgeable," he is "able to separate what can kill you from what will kill you in this space," according to *Chambers Global* 2013.
- According to Lexology’s 2013 Client Choice Awards, Jon "knows his subject inside-out," "communicates efficiently and effectively" and "always adds value by offering new insight or comfort on difficult issues."
- According to *Chambers USA* 2012, Jon is “very thoughtful, creative and knowledgeable."
- *Legal 500* 2010 called him "an excellent Structured Finance lawyer, outstanding on all of the elements."
- And *IFLR 1000* 2008 noted that Jon's work receives "substantial praise from clients and competitors."

In 2008, Jon was named on *Crain's Chicago Business* "40 Under 40," a prestigious honor where he was applauded for his ability to "operate like an executive, moving beyond legal questions and offering strategic and tactical insight rare for a lawyer of his vintage." This is one of the most prestigious awards that a young professional can receive, and Jon now joins other "40 Under 40" alumni including President Barack Obama.

Jon is a frequently requested speaker on finance issues and he has published articles on a wide range of structured finance-related topics. In 2008, Jon edited and co-authored *Credit Market & Subprime Distress: Responding To Legal Issues*, a best-selling legal treatise on the credit crisis published by the Practicing Law Institute. Reviews of this book have praised it for providing "a clear analysis of the relevant issues without getting bogged down in the minutiae of the procedures."

He is also frequently sought by top-tier media such as the *Associated Press*, *Bloomberg News*, *Dow Jones Newswires*, *Financial Times*, *The New York Times* and *The Wall Street Journal* to provide insight and analysis of issues related to the finance and banking industries.

Jon is an adjunct professor at the John Marshall Law School in Chicago, and is also active in the Chicago community as a Leadership Greater Chicago fellow.

Experience

- Structured and negotiated multiple mortgage loan securitization transactions and structured warehouse facilities issuing both public and private securities, including REMIC and non-REMIC structures for commercial and residential mortgage loans, home equity lines of credit, home equity loans and nonperforming loans.
- Structured and negotiated multiple one-off and flow asset purchase arrangements for mortgage loans, mortgage servicing rights, auto loans, insurance policies, and consumer finance origination and servicing platforms, ranging in size up to $55 billion.
- Structured and negotiated multiple public auto loan and auto lease term securitization transactions, including transactions with asset-backed derivative instruments and financial guaranty insurance.
- Structured and negotiated multiple home equity loan securitization transactions issuing both public and private securities, including REMIC and non-REMIC structures for home equity lines of credit, home equity loans and nonperforming loans.
- Prepared multiple Regulation AB compliant shelf registration statements for auto receivables, mortgage loans and home equity loans, including registrations by foreign issuers.
- Negotiated asset-backed interest rate and currency swap transactions, including transactions conforming with criteria for ratings dependent swaps.
- Negotiated and documented multiple market value swaps for mortgage loan-backed and securities-backed funding vehicles.
- Negotiated credit derivatives for a large monoline insurance company.
- Structured and negotiated several cross border mortgage loan securitization transactions, including transactions issuing publicly registered asset-backed securities.

Education

- Calvin College, BA, 1991

- Southern Methodist University Dedman School of Law, JD, cum laude, 1994; Staff Editor, *The International Lawyer*

Admissions

- New York, 2004
- Illinois, 1998
- Texas, 1994

News & Publications

- "Eight Mayer Brown and T&C lawyers recognized as winners of 2013 International Law Office (ILO) Client Choice awards," 28 February 2013
- "Foreclosure-rental ABS deals in the works," *International Financing Review*, 24 August 2012
- "Overview of the Proposed Credit Risk Retention Rules for Securitizations," *Mayer Brown White Paper*, 8 April 2011
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- "US SEC Proposes Rules on ABS Warranty Repurchase Reporting," *Mayer Brown Legal Update*, 6 October 2010
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- "S&P and Fitch Announce Special Designations for Structured Finance Ratings," *Mayer Brown Legal Update*, 23 February 2010
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- "Recent Changes to Mortgage Regulation Panel II – RMBS Litigation, Representations and Warranties, and Securities Laws," The Return of Private Capital to the Mortgage Market, NYU Leonard N. Stern School of Business, Center for Real Estate Finance Research – Winter Symposium, 5 March 2013
- "Non-Performing Loan Securitizations and Other Distressed Opportunities," ASF Conference, 29 January 2013
- Securitization—What's In Store for 2013?, 17 January 2013
- What Fits? Capitalizing on Opportunities Created By Today's Markets, 1 March 2012
- Strategies for Dealing with Financial Asset Businesses and Portfolios—Part I: M&A of Financial Asset Businesses, 3 March 2011
- Restructuring Bank Balance Sheets—Synthetic Risk Transfer, 20 May 2010
- Rating Agency Reform, 4 March 2010
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Tab 9

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17 May 2013
Mayer Brown Legal Update

The ISDA March 2013 Dodd-Frank Protocol (the "DF Protocol 2.0") is Open for Adherence

On March 22, 2013, ISDA opened the DF Protocol 2.0 for adherence to market participants. The DF Protocol 2.0 is part of ISDA's documentation initiative aimed at assisting the derivatives industry in implementing and complying with the regulatory requirements imposed under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). The DF Protocol 2.0 facilitates the swap dealers' and major swap participants' compliance with certain swap dealer external business conduct rules of the Commodity Futures Trading Commission ("CFTC") that were published after the ISDA August 2012 Dodd-Frank Protocol ("DF Protocol") by providing a standardized way of amending existing swap documentation to respond to these new requirements. The June 10 mandatory clearing phase-in for certain non-swap dealer financial businesses and the July 1 compliance date for certain business conduct rules are important drivers of this protocol effort. The DF Protocol 2.0 addresses the requirements of the following three CFTC final rules:

- CFTC, Final Rule, *Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants*, 77 Fed. Reg. 55904 (September 11, 2012);
- CFTC, Final Rule, *End-User Exception to the Clearing Requirement for Swaps*, 77 Fed. Reg. 42559 (July 19, 2012); and
- CFTC, Final Rule, *Clearing Requirements Determination Under Section 2(h) of the CEA*, 77 Fed. Reg. 74284 (Dec. 13, 2012).

The DF Protocol 2.0 allows market participants to (i) supplement the terms of existing ISDA Master Agreements or (ii) enter into an agreement to apply select Dodd-Frank compliance provisions to their swap trading relationship, including, among other things, terms governing payment obligations or an agreement by the parties to clear certain swap transactions.

The DF Protocol 2.0 basic architecture is similar to the DF Protocol. It consists of four documents: (1) the adherence letter, (2) the protocol agreement, (3) the protocol questionnaire and (4) the DF supplement. The substantive provisions in the DF Protocol 2.0 are in the DF supplement which consists of following four Schedules:

- Schedule 1: definitions
- Schedule 2: general terms for parties' agreements with respect to confirmation documentation, clearing and end-user exception, and Orderly Liquidation Authority notices;

- Schedule 3: parties' agreements regarding the daily valuation of swaps for swap trading relationship documentation purposes and related dispute resolution procedures; and
- Schedule 4: parties' agreements regarding the portfolio reconciliation process.

Schedules 1 and 2 are deemed incorporated into existing documentation once a party adheres to the DF Protocol 2.0. Schedules 3 and 4 are optional.

The DF Protocol 2.0 includes additional bilateral delivery requirements, including a protocol questionnaire, to allow counterparties to make certain elections related to their swap trading relationship under Dodd-Frank. Notably, any party that selected "No Answer" in response to the question whether or not it is a "financial entity" in the DF Protocol questionnaire must now, in the DF Protocol 2.0 questionnaire, answer the question of whether or not it is a "financial entity" with a "yes" or "no" response.[1]

Like the DF Protocol, adhering parties may use the online system "ISDA Amend" to submit and exchange documents and questionnaires with counterparties. Questionnaire submission will be available on May 24, 2013. There is no cut off date for adherence. As with the DF Protocol, there is a $500 fee to ISDA to adhere to the DF Protocol 2.0.

For more information on the topics raised in this Legal Update, please contact Joshua Cohn at

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[1] This is an apparent response to rules relating to swap trading relationship documentation and confirmation timing.

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Federal Reserve Proposes Enhanced Prudential Standards for Non-US Banking Organizations

On December 14, 2012, the Board of Governors of the Federal Reserve System (FRB) released a 300-page proposed rule (the Proposal) that would implement Sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) for foreign banking organizations (FBOs).[1] The Proposal would impose heightened prudential requirements (including capital, liquidity, single-counterparty credit limits, risk management, stress testing, and early remediation) on the US operations of foreign banking organizations having global consolidated assets of $50 billion or more. However, certain standards would apply to FBOs with consolidated assets of $10 billion or more, regardless of the size of their US operations.[2]

The Proposal represents a significant departure from FRB's long-standing tailored approach to supervising the US operations of FBOs, which relies significantly on consolidated supervision by home-country authorities in accordance with international standards and the willingness and ability of the FBO to support its US operations under various conditions. Under the current supervisory framework, FBOs generally have enjoyed substantial flexibility in how they structure their US operations (e.g., direct branching, direct or indirect ownership of bank and nonbanking subsidiaries), an approach intended to facilitate cross-border banking and increase the global flow of capital and liquidity. Congress established this framework both to implement the policy of national treatment, which was characterized in its classic formulation in the International Banking Act of 1978 (IBA), as amended, as "parity of treatment in like circumstances," as well as in recognition of the structures that US banks preferred for their own global operations. Such a framework also promoted the efficient allocation of capital and liquidity within global organizations operating on a cross-border basis.

The financial crisis of 2008 has resulted in a reevaluation of this framework. Although the FRB has acknowledged that the United States did not suffer a destabilizing failure of foreign banks, the concern that the absence of liquidity or specific capital in local markets could make such operations more vulnerable to economic disruptions led to a reevaluation of the historic approach to foreign bank regulation that is reflected in the Proposal.

Sections 165 and 166 of the Dodd-Frank Act directed the FRB to impose enhanced prudential standards on FBOs having global consolidated assets of $50 billion or more. Because of the difficulties it anticipates in monitoring compliance with those standards at the level of the consolidated FBO, the FRB is proposing to require a uniform organizational structure for the US operations of the largest FBOs, a US intermediate holding company (IHC), on which the enhanced standards would be imposed. These enhanced standards are intended to increase the resilience of the US operations of FBOs to stressed conditions and to minimize the risk posed to the US financial system in the event of the FBO's failure.

The proposed enhanced prudential standards are lengthy, complex, often ambiguous, and likely to be controversial. The good news is that, consistent with the intent of the Congress in the IBA, the FRB is not seeking to force foreign banks to "roll up" their US branches and agencies (US branches) into separately incorporated subsidiaries that are part of the IHC. However, the requirement that larger FBOs establish IHCs, which was not required or even considered by the Congress in the Dodd-Frank Act, will likely lead to inefficiencies and greater costs. Moreover, even FBOs with consolidated global assets of as little as $10 billion and minimal US operations will be subjected to US-imposed stress testing and governance requirements, and could face additional restrictions.

For these reasons, the Proposal as a whole raises serious policy concerns, including whether it may encourage foreign governments to impose similar or even more burdensome requirements on the non-US operations of US banks, and undermine efforts to develop common global standards, such as the Basel Committee on Banking Supervision's (BCBS) proposed capital and liquidity standards, as well as development of an effective cross-border resolution regime. In addition, the Proposal could adversely affect the US economy if it leads FBOs to scale back or even eliminate their US operations, or makes them less efficient.

Despite the FRB's cautions to the contrary, the Proposal also provides some insight into how the FRB's thinking may have evolved concerning several key aspects of its December 2011 proposal that would impose similar enhanced prudential standards on US bank holding companies (2011 Domestic Proposal).

The proposed enhanced prudential standards generally would take effect on July 15, 2015. Although the various size thresholds under the Proposal would be based on an average of the FBO's total consolidated assets for the prior four consecutive quarters, the delayed effective date may nevertheless provide some FBOs with assets near the proposed thresholds with incentives to try to ensure that they fall (and remain) below those thresholds on the effective date.

This update provides an overview of the key components of the FRB's Proposal and highlights significant issues for consideration. The comment period for the Proposal ends on March 31, 2013.

US Intermediate Holding Company Requirement

The Proposal generally would require any FBO that has (i) $50 billion or more of consolidated global assets and (ii) at least $10 billion in assets in US subsidiaries to organize its US subsidiaries under a single IHC. This IHC would then be subject to the Proposal's enhanced prudential standards and early remediation requirements. Key highlights and considerations relating to the IHC proposal include the following:

- **Calculation of $10 Billion Threshold**. For purposes of calculating the threshold, US subsidiaries would be defined using the Bank Holding Company Act (BHCA) definition of control and would include all US subsidiaries regardless of where they might currently be held in the global organization (including presumably through a US branch). The calculation would include US subsidiaries held through merchant banking authority and presumably non-US subsidiaries held through US subsidiaries (on a consolidated US basis). US subsidiaries held through the Section 2(h)(2) BHCA authority would not be included. In addition, assets reflecting inter-affiliate transactions between US subsidiaries would be excluded. Assets held in US branches of foreign banks would be excluded from the calculation of the $10 billion in US assets. FRB plans to monitor closely any attempts to shift assets from US subsidiaries to US branches to avoid the IHC threshold (or other aspects of the Proposal such as enhanced local capital standards), although it notes that any such transfers would be constrained by a number of factors, including legal restrictions on the kinds of assets that can be booked in US branches. In addition to challenging the concept of required use of IHCs, comment letters could recommend that the threshold for establishment of an IHC be set higher on the basis that in other contexts (e.g., resolution plan requirements), the FRB has implicitly acknowledged that companies with assets of $10 billion are unlikely to have systemic implications for the US financial system. Comment letters could also point out that the IHC requirement is contrary to policy in other jurisdictions that permit US banks to operate subsidiary businesses without establishing an intermediate holding company. Finally, commenters may wish to object to use of the BHCA control standard in this context, since its broad scope and lack of objectivity will likely raise practical problems in achieving compliance with the IHC requirement for certain subsidiaries.

- **Covered US Subsidiaries**. The same US subsidiaries included in the calculation of the $10 billion threshold would be required to be held under the IHC. This could create tax and other legal issues with respect to restructuring current holdings. In addition to US bank subsidiaries, all US nonbank subsidiaries (other than 2(h)(2) companies), such as broker-dealers, finance companies, and insurance companies, would be held under the IHC. Likewise, special purpose entities (SPEs) and other transaction-related subsidiaries would have to be structured through the IHC. There is no indication that subsidiaries held through US branches would be excluded, even though the assets of the US branches would be excluded from the threshold calculation. Comment letters should address any concerns in this regard, including transition and grandfathering arrangements where reasonable.
- **Flexibility**. In general recognition that the IHC requirement may not fit in all cases, the Proposal would give the FRB flexibility in "exceptional" circumstances to permit an FBO to use an "alternative organizational structure" based on the FBO's "activities, scope of operations, structure, or similar considerations." For example, multiple IHCs could be permitted for an FBO controlling more than one foreign bank with US operations, or where home-country laws prohibit use of a single US holding company. This flexibility could also be important to FBOs that own other major non-US financial services firms that are operated separately from the FBO's foreign bank subsidiaries. Comment letters could address additional specific areas where flexibility is needed to accommodate legal, regulatory, and tax considerations.
- **Regulatory Requirements**. In addition to meeting the enhanced prudential standards, the IHC would be subject to reporting and recordkeeping requirements currently applicable to bank holding companies. To the extent that the IHC would also be a domestic bank holding company (BHC) subject to the FRB's Section 165 enhanced prudential standards for large domestic banking organizations, the enhanced prudential standards for IHCs would apply, rather than the domestic counterparts. The FRB may provide further guidance on various other regulatory requirements that will apply to IHCs.
- **Legal Authority**. Nothing in the Dodd-Frank Act specifically requires or mandates use of IHCs. However, the FRB is relying on its broad authority under the Dodd-Frank Act to supervise foreign banks with more than $50 billion in global assets, as well as its other broad sources of statutory authority over

foreign banks, to justify adoption of the IHC requirement.

- **Effective Date**. The threshold calculations would be made as of July 1, 2014, and the IHC would be required to be established by July 1, 2015, unless the FRB extends that period in writing. Existing US holding company structures could be used.
- **Notice Requirement**. The FRB would require an after-the-fact notice of the establishment of the IHC. The Proposal does not address procedures relating to establishment of a de novo IHC over an existing US bank.

Risk-Based Capital and Leverage Requirements

The Proposal would supplement the FRB's traditional approach of relying primarily on consolidated capital requirements measured under home-country standards when assessing the capital adequacy of FBOs seeking to expand or establish US operations with one requiring allocation of local capital specifically to the US holding companies of the largest US bank and nonbank subsidiaries of foreign banks. Key highlights and considerations relating to the proposed enhanced capital requirements for foreign banks include the following:

- **Rationale**. Among the key factors cited by the FRB for the proposed enhanced capital requirements are: (i) an increased focus on the risk to US financial stability posed by the US operations of the largest foreign banking organizations, (ii) increased doubts about the ability and willingness of parent FBOs to support their US operations during periods of stress, and (iii) incentives for home and host countries to restrict cross-border intra-group capital flows when global banking organizations face financial difficulties, due to the difficulties in developing an effective cross-border resolution regime for global foreign banks. Points that are likely to be made by commenters are that ring-fencing of US subsidiary operations through the imposition of host-country capital requirements interferes with capital allocations within global firms, is contrary to the cooperative intent behind the development of international capital standards, and is contrary to the approach taken by most other jurisdictions.
- **IHCs**. Any FBO required to establish an IHC would be required to ensure that the IHC maintained sufficient local capital to comply with all US capital requirements as if the IHC were a US BHC (i.e., even if the FBO does not control a US bank subsidiary). These requirements would include the general US risk-based capital requirements (currently based on Basel I but likely to be replaced by the July 2015 effective date of this Proposal by the pending US proposal to implement Basel III), and, as applicable, the "advanced approaches" risk-based requirements (which also would be modified under the pending US Basel III proposals) and "market risk" requirements. The US leverage capital requirement also would apply to the IHC.
- **Large IHCs**. IHCs with $50 billion or more in consolidated assets also would be subject to the FRB's capital plan rules and required to submit an annual capital plan demonstrating the ability of the IHC to maintain capital above the required minimum ratios under both baseline and severely stressed conditions over at least nine quarters or face restrictions on its ability to make capital distributions. Large IHCs determined to be systemically important in the United States also could be subject to additional capital surcharges.
- **FBOs Not Subject to IHC Requirement**. FBOs with at least $50 billion in consolidated global assets, but not required to establish an IHC, would have to certify to the FRB that they met consolidated home-country risk-based capital requirements "consistent with" the global Basel III framework (taking into account available transition periods). Covered

FBOs from countries that have not adopted Basel III would have to "demonstrate" to FRB that their capital is in fact "consistent" with Basel III standards. Covered FBOs also will be required to certify or otherwise demonstrate compliance with the international leverage ratio under Basel III, which is scheduled to take effect in 2018. Consistent with its existing policy, the FRB is not proposing to require covered FBOs to meet the current 4 percent US leverage ratio in the interim; however, it has specifically requested comment on that issue. The Proposal is vague, perhaps deliberately so, as to how home-country deviations from the global Basel III framework will be taken into account for these purposes. The FRB would have discretion to limit the US activities or operations of any covered FBOs that could not satisfy these enhanced capital requirements.

- **Reports**. All FBOs with at least $50 billion in consolidated assets would be required to file an expanded FR Y-7Q on a quarterly basis. Currently, only those FBOs that are FHCs are required to file quarterly rather than annually.

Liquidity Requirements

The Proposal would implement a set of specific liquidity requirements for FBOs with consolidated global assets of $50 billion or more. The requirements differ significantly for FBOs with combined (branch, agency, and IHC or subsidiary operations) US assets of less than $50 billion as compared to those with combined assets of more than $50 billion. Key aspects of the Proposal are highlighted below:

- **FBOs with Combined US Assets Less Than $50 Billion**. Under the Proposal, FBOs with $50 billion or more in total consolidated assets, but whose combined US assets are less than $50 billion, would be required to report to the FRB annually on the results of internal liquidity stress testing for either the consolidated operations of the FBO or its combined US (branch, agency, and IHC or subsidiary) operations conducted in accordance with BCBS principles for liquidity risk management and incorporating 30-day, 90-day, and one-year test horizons. Failure to comply would result in the FBO having to maintain its combined US operations in a net due-to funding position or a net due from funding position with non-US affiliated entities equal to not more than 25 percent of the third-party liabilities of its combined US operations on a daily basis.
- **FBOs with Combined US Assets of $50 billion or More**. For FBOs with total consolidated assets of $50 billion or more and combined US assets of $50 billion or more, the liquidity-management, testing, and reporting obligations would be much more extensive. These requirements would apply across the FBO's US operations – both branch and agency networks and the IHC. For this category of FBO, the Proposal contemplates a liquidity management framework that features: (i) active involvement on the part of the institution's risk committee and chief risk officer in the management of liquidity risk; (ii) regular cash flow projections; (iii) monthly liquidity stress testing; (iv) the maintenance of a buffer of highly liquid assets primarily in the United States to cover cash flow needs under stressed conditions; (v) the maintenance of a contingency funding plan; (vi) specific limits on funding sources; and (vii) collateral monitoring.
- **Framework for Managing Liquidity Risk**. As explained in greater detail in the Risk Management and Risk Committee Requirements section, below, the Proposal requires FBOs with consolidated global assets of $50 billion or more and combined US assets of $50 billion or more to establish a risk committee and to appoint a chief risk officer. The risk committee would be responsible for setting the liquidity risk tolerance of the FBO's US operations. The chief risk officer would have responsibilities for implementing the

FBO's liquidity risk framework including (i) approving the liquidity costs, benefits, and risks of each significant new business line engaged by the US operations and each significant new product offered, managed, or sold through the US operations before the company implements the business line or offers the product, and (ii) approving the size and composition of the liquidity buffer.

- **Monitoring Requirements**. FBOs with combined US assets of $50 billion or more would be required to monitor liquidity risk related to collateral positions of the US operations, liquidity risks across the US operations, and intraday liquidity positions for the combined US operations. The Proposal also requires monitoring of collateral positions in order to enable weekly calculation of the assets of the combined US operations that are pledged as collateral for an obligation or position and the assets that are available to be pledged. In addition, FBOs with combined US assets of $50 billion or more would be required to establish and maintain an independent (of management) review function to evaluate the adequacy and effectiveness of the liquidity risk management of the combined US operations.
- **Comprehensive Cash Flow Projections**. The Proposal would require FBOs with combined US assets of $50 billion or more to produce short- and long-term projections of cash flows arising from assets, liabilities, and off-balance sheet exposures and identify and quantify discrete and cumulative cash flow mismatches over these time horizons.
- **Liquidity Stress Test Requirements**. FBOs with combined US assets of $50 billion or more would be required to conduct monthly stress tests of the IHC and the US branch network. The results of these monthly stress tests would be provided to the FRB. FBOs would also be required to provide the FRB with a summary of the results of any liquidity stress test and the amount of any liquidity buffers required by home-country regulators.
- **Liquidity Buffer**. The US branch network and the IHC would each be required to maintain a separate liquidity buffer consisting of high-quality liquid assets equal to net stressed cash flow needs over a 30-day stressed horizon. Net stressed cash flow needs would include separate calculations of both external (i.e., unaffiliated third parties) and internal (i.e., head office and affiliates) net cash flows (intended to minimize the ability of FBOs to rely on intra-group cash flows to meet external cash flow needs).[3] The calculation methodology for internal net stressed cash flows would be designed to provide an FBO with incentives to minimize maturity mismatches between its US operations and its head office and affiliates. In the case of an IHC, all liquid assets used to meet the buffer would have to be held in the United States (cash assets could not be held at an account of an affiliate of the IHC). US branches would be required to hold liquid assets in the United States sufficient to cover net stressed cash flow needs for at least the first 14 days of the stress test horizon (again, cash could not be held at an affiliate). However, for days 15 through 30 of the stress test horizon, the US branch network would be permitted to maintain the liquidity buffer outside the United States, provided the FBO could demonstrate, to the satisfaction of the FRB, ready availability and access to those assets by the US branch network.
- **Liquidity Buffer Composition**. Only highly liquid, unencumbered assets would be included in a liquidity buffer, including cash or securities issued or guaranteed by the US government. Other assets could be included if the FBO can demonstrate to the satisfaction of the FRB that the asset has low credit risk and low market risk, is traded in an active secondary two-way market, and is a type of asset that investors historically have

purchased in periods of financial market distress (flight to quality) such as certain "plain vanilla" corporate bonds. An asset is considered unencumbered if (i) the asset is not pledged, does not secure, collateralize, or provide credit enhancement to any transaction, and is not subject to any lien, or, if the asset has been pledged to a Federal Reserve Bank or a US government-sponsored enterprise, the asset has not been used, (ii) the asset is not designated as a hedge on a trading position under the FRB's market risk rule, and (iii) there are no legal or contractual restrictions on the ability of the company to promptly liquidate, sell, transfer, or assign the asset.

- **Contingency Funding Plan**. The FBO would be required to establish and maintain a contingency funding plan for its combined US operations. The plan would have to be commensurate with the complexity and profile of the US operations and specific to US legal entities, including the US branch network and the IHC. The objective would be to provide a plan for responding to a liquidity crisis, to identify alternative sources that the US operations can access during liquidity stress events, and to describe steps that would be taken to ensure that the company's sources of liquidity are sufficient to fund its operating costs and meet its commitments while minimizing additional costs and disruption. The four components of the plan would consist of (i) quantitative assessment, (ii) event management procedures, (iii) monitoring procedures, and (iv) testing requirements.
- **Specific Concentration Limits**. The Proposal would require FBOs with combined US assets of $50 billion or more to establish and maintain limits on concentrations of funding by instrument type, single-counterparty, counterparty type, secured and unsecured funding, and other liquidity risk identifiers such as the amount of specified liabilities that mature within various time horizons and off-balance sheet exposures that could create funding needs during liquidity stress events.

Single-Counterparty Credit Limits

To limit risk from the failure of an individual firm, the single-counterparty credit limits would cap the credit exposure of an IHC and the combined US operations of an FBO with $50 billion or more in global consolidated assets to any unaffiliated counterparty, with more stringent requirements placed on the IHCs and FBOs with the largest US presence. Key highlights and considerations relating to the proposed single-counterparty credit limits rule include:

- **Credit Exposure Limited to 25 Percent of Regulatory Capital**. The Proposal would prohibit an IHC or the combined US operations of an FBO with $50 billion or more in global consolidated assets from having aggregate net credit exposure to any single unaffiliated counterparty above 25 percent of the IHC's capital stock and surplus or above 25 percent of the FBO's consolidated capital stock and surplus. Under the Proposal, "capital stock and surplus" for IHCs would be defined as the sum of the company's total regulatory capital as calculated under the risk-based capital adequacy guidelines applicable to that IHC under the Proposal, and the balance of the allowance for loan and lease losses of the IHC not included in tier 2 capital under those guidelines. For FBOs without IHCs, due to differences in international accounting standards, FBO capital stock and surplus would be defined as the total regulatory capital of such company on a consolidated basis, as determined according to the enhanced capital requirements of the Proposal, and would not reflect the balance of the allowance for loan and lease losses not included in tier 2 capital. The FRB has requested comment on whether alternative methods of calculating capital stock and surplus should be considered, including a stricter alternative tied to tier 1 common equity.

- **More Stringent Limit Imposed on Largest IHCs and FBOs.** The Proposal would impose a more stringent limit (somewhere between 10 percent and 25 percent) on aggregate net credit exposures between "major" IHCs or "major" FBOs (IHCs and FBOs with total consolidated assets of $500 billion or more) and "major" counterparties (a BHC or FBO with total consolidated assets of $500 billion or more, and any nonbank financial company supervised by the FRB). This limit, not specified in the Proposal, would be consistent with the limit established for major US BHCs and US nonbank financial companies supervised by the FRB. The 2011 Domestic Proposal contained a 10 percent limit for this purpose, which was strongly criticized in industry comment letters. Thus, the FRB's decision not to include a specific limit in the Proposal appears to reflect its acknowledgement that greater flexibility is needed. The FRB may amend the Proposal to conform to any international standard that may be adopted for limiting large exposure limits for banking organizations. The FRB has also requested comment on whether it should adopt a more nuanced approach (along the lines of the 12-factor approach to determine the systemic importance of a global banking organization proposed by the BCBS proposal on capital surcharges) to determining which IHCs and FBOs should be considered major IHCs or major FBOs.
- **Definition of Credit Exposure.** Credit exposures include: (i) all extensions of credit to a counterparty, including loans, deposits, and lines of credit; (ii) all repurchase agreements, reverse repurchase agreements, and securities borrowing and lending transactions with a counterparty; (iii) all guarantees, acceptances, or letters of credit (including endorsement or standby letters of credit) issued on behalf of a counterparty;
(iv) all purchases of or investments in securities issued by the counterparty;
(v) credit exposure to a counterparty in connection with a derivative transaction, as well as credit exposure to a reference entity, where the reference asset is an obligation or equity security of a reference entity; and
(vi) any other similar transaction that the FRB determines to be a credit exposure for these purposes.
- **Calculation of Aggregate Net Credit Exposure.** Aggregate net credit exposure would generally be determined by calculating the FBO's gross credit exposure (together with the exposure of its subsidiaries) and applying adjustments (e.g., by taking into account eligible collateral, eligible guarantees, eligible credit and equity derivatives, other eligible hedges, and the effect of bilateral netting agreements on securities financing transactions). Calculation of gross and net credit exposure under the Proposal generally would be the same as under the 2011 Domestic Proposal. Notably, despite significant criticism of the "current exposure method" for measuring derivatives exposure, the Proposal would continue to mandate its use by FBOs for measuring derivatives exposure for derivatives subject to qualifying master netting agreements. However, in recognition of the fact that a qualifying netting agreement applicable to a US branch may cover exposures of other FBO offices, FBOs would be permitted to use a "gross valuation methodology" applicable to derivatives not subject to a qualifying master netting agreement. Aggregate net credit exposure would have to be calculated on a daily basis, and monthly compliance reports submitted to the FRB. In the event of noncompliance, the Proposal generally would prohibit a covered IHC or the combined US operations of an FBO

from engaging in additional credit transactions with the counterparty.

- **Definition of "Subsidiary."** In calculating its aggregate net credit exposure to a counterparty, an IHC or FBO with $50 billion or more in global consolidated assets would be required to include the exposures of its US subsidiaries to the counterparty. Likewise, credit exposure to a counterparty would include exposures to any subsidiaries of that counterparty. Under the Proposal, a company would be a subsidiary if it is directly or indirectly controlled by another company. A company would control another company if it: (i) owns or controls with the power to vote 25 percent or more of a class of voting securities of the company; (ii) owns or controls 25 percent or more of the total equity of the company; or (iii) consolidates the company for financial reporting purposes. This definition of control is more limited than that of the BHCA and the FRB's Regulation Y, and would generally exclude funds and special purpose vehicles that are sponsored or advised by a covered IHC or combined US operations of an FBO.
- **Attribution Rule**. The Proposal would require that an IHC, or, with respect to its combined US operations, an FBO with $50 billion or more in global consolidated assets, should treat a transaction with any person as a credit exposure to a counterparty to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that counterparty.
- **Government and Other Exemptions**. The Proposal would cover credit exposures to persons, companies, foreign sovereign entities, and US state and local governments. The Proposal would exempt credit exposures to the US federal government (including its agencies, as well as Fannie Mae and Freddie Mac, while those entities are under conservatorship or receivership) as well as the FBO's home-country sovereign. In addition, intraday credit exposures to a counterparty would be exempted, to help minimize the effect of the Proposal on the payment and settlement of financial transactions. The FRB may make other exemptions it determines are in the public interest and are consistent with the purposes of the Proposal.

Risk Management and Risk Committee Requirements

The Proposal would require FBOs that are publicly traded with total consolidated assets of $10 billion or more and all FBOs with total consolidated assets of $50 billion or more, regardless of whether their stock is publicly traded, to establish a risk committee to oversee their US operations. FBOs with total consolidated assets of $50 billion or more, and combined US assets of $50 billion or more, also would be required to appoint a US chief risk officer who would be responsible for implementing and maintaining a risk management framework for the company's combined US operations. These standards generally align with those proposed for domestic bank holding companies in December 2011, adjusted to some extent to take into account the specific structures of FBOs.

- **Organizational Alternatives**. The US risk committee requirement could be satisfied if it is organized as a committee of the global board of directors or as a committee of the board of directors of the IHC. Thus, except as noted below, the US risk committee would not be required to be located in the United States. If the US risk committee is a committee of the global board, it could be organized on a stand-alone basis or as part of the enterprise-wide risk committee. However, an FBO with combined US assets of $50 billion or more that conducts operations in the United States solely through an IHC (i.e., no direct branches) would be required to maintain its US risk committee at the IHC level in the United States.

- **US Risk Committee Requirements**. Whether organized at the parent or IHC level, at least one member of the risk committee must have risk management expertise commensurate with the capital structure, risk profile, complexity, activities, and size of the FBO's combined US operations. In addition, the level of expertise among committee members should be commensurate with the complexity and profile of the company.
- **Responsibilities of the US Risk Committee**. The risk committee would oversee the operation of the risk management framework, and that framework would be required to correspond to the size, complexity, capital structures, activities, and risk profile of the FBO. The framework would have to include: (i) policies and procedures relating to risk management governance, risk management practices, and risk control infrastructure for the combined US operations of the FBO; (ii) processes and systems for identifying and reporting risks and risk management deficiencies; (iii) processes and systems for monitoring compliance with the policies and procedures; (iv) processes designed to ensure effective and timely implementation of corrective actions to address risk management deficiencies; (v) specification of management's and employees' authority and independence to carry out risk management responsibilities; and (vi) integration of risk management control objectives in the management goals and the compensation structure of the combined US operations.
- **Additional Requirements for FBOs with Combined US Operations of $50 Billion or More**. FBOs with combined US operations of $50 billion or more would be required to appoint a US chief risk officer in charge of overseeing and implementing the risk management framework of the company's combined US operations. These FBOs also would be required to appoint at least one independent member to the risk committee who is not, or has not been, an officer or employee of the FBO or its affiliates during the previous three years, or a member of the immediate family of a person who is, or has been in the last three years, an executive officer of the FBO or its affiliates. This requirement would apply regardless of where the US risk committee is located.
- **Risk Officer Requirements**. All FBOs would be required to have risk management expertise commensurate with the capital structure, risk profile, complexity, activity, and size of the combined operations of the FBO. The risk officer would be required to be compensated at a level that ensures objective assessment of the risk taken by the company's combined US operations, and would report directly to the US risk committee and the company's global risk officer (though alternative reporting structures could be approved by the FRB on a case-by-case basis).
- **Risk Officer Responsibilities**. The risk officer would be responsible for overseeing the development of processes and systems for identifying and reporting risks and risk management deficiencies and ensuring that risk management deficiencies are resolved in a timely manner. In addition, the responsibilities of a risk officer would include overseeing the regular provision of information to the US risk committee, the global chief risk officer, and the FRB. The risk officer would be expected to oversee regularly scheduled meetings, including special meetings with the FRB, to assess compliance with risk management responsibilities, as well as the implementation of and ongoing compliance with appropriate polices and procedures relating to risk management governance, practices, and risk controls of the combined US operations.

Stress Test Requirements

The Proposal would seek to adapt for FBOs the requirements of stress testing rules currently applicable to US bank holding companies. IHCs with total consolidated assets of $10 billion or more but less than $50 billion would be required to conduct annual company-run stress tests. IHCs with assets of $50 billion or more would be required to conduct semi-annual company-run stress tests and would be subject to annual supervisory stress tests. The Proposal also would apply stress testing requirements to US branches by first evaluating whether the home-country supervisor for the FBO conducts a stress test and, if so, whether the stress testing standards applicable to the consolidated FBO in its home-country are broadly consistent with the US stress testing standards. If the US branches are net funders of head office and other affiliates, the FBO would have to provide additional information concerning home country stress test results in order to satisfy the FRB that its capital under stressed conditions would be adequate to ensure it could continue to support its US operations. Even FBOs with between $10 billion and $50 billion in consolidated assets would have to be subject to home-country stress testing, or face asset maintenance restrictions on its US branches.

- **Stress Test Requirements for IHCs with Combined US Assets of $50 Billion or More**. An IHC with total consolidated assets of $50 billion or more would be required to conduct two company-run stress tests per year, with one test using scenarios provided by the FRB (the annual test) and the other using scenarios developed by the company (the mid-cycle test). The IHC would be required to file a regulatory report containing the results of the annual test by January 5 and to publicly disclose a summary of the results between March 15 and March 31 each year. The mid-cycle results would have to be filed by July 5 and disclosed publicly in summary form between September 15 and September 30. Concurrently with the IHC's annual company-run stress test, the FRB would conduct a supervisory stress test using scenarios identical to those provided for the annual company-run stress test. The FRB would disclose a summary of the results no later than March 31 of each calendar year.
- **Stress Test Requirements for FBOs with Combined US Assets of $50 Billion or More**. The US branch network of an FBO with combined US assets of $50 billion or more would be subject to a consolidated capital stress testing regime that includes either (i) an annual supervisory capital stress test conducted by the FBO's home-country supervisor or (ii) an annual evaluation and review by the FBO's home-country supervisor of an internal capital adequacy stress test conducted by the FBO. In either case, the home-country stress testing regime would have to set forth requirements for governance and controls of the stress testing practices by relevant management and the board of directors of the FBO. FBOs would be obligated to submit information to the FRB regarding the results of home-country stress tests, including: (i) a description of the types of risks included in the stress test; (ii) a description of the conditions or scenarios used in the stress test; (iii) a summary description of the methodologies used in the stress test; (iv) estimates of the FBO's projected financial and capital condition; and (v) an explanation of the most significant causes for the changes in regulatory capital ratios. Significantly, if the US branch network is in a net due from position to the FBO, calculated as the average daily position from a given October- to-October period, the FBO would be required to report additional information to the FRB on its stress tests, including: (i) a detailed description of the methodologies used in the stress test; (ii) detailed information regarding the organization's projected financial and capital position over the planning horizon; and (iii) any additional information the FRB

deems necessary to evaluate the FBO's ability to absorb losses in stressed conditions.

- **FBO Failure to Comply with Stress Test Requirements**. In the event an FBO with combined US assets of $50 billion or more fails to meet the stress test requirements listed above, the FRB would require its US branch network to maintain eligible assets (as defined under New York law) equal to 108 percent of third-party liabilities, i.e., an asset maintenance requirement. Additionally, the FBO would be required to conduct an annual stress test of any US subsidiary not held under an IHC (other than a 2(h)(2) company), separately or as part of an enterprise-wide stress test, to determine whether the subsidiary has capital necessary to absorb losses as a result of adverse economic conditions, and to report summary information about the results to the FRB on an annual basis. In addition, the FRB could impose intra-group funding restrictions on the US operations of the FBO or could impose increased local liquidity requirements.
- **Stress Test Requirements for FBOs with Total Consolidated Assets of More than $10 Billion**. An FBO with total consolidated assets of $10 billion or more would be subject to a consolidated capital stress testing regime that includes either an annual supervisory capital stress test conducted by the company's supervisor or an annual evaluation and review by the company's home-country supervisor of an internal capital adequacy stress test conducted by the company. Such an FBO would not be subject to separate information requirements imposed by the FRB relating to the results of stress tests. Failure to meet this requirement would result in the FRB requiring the branch and agency network to meet a 105 percent asset maintenance requirement (lower than the 108 percent requirement above due to the more limited risk this category of FBO poses to the US economy). Companies that do not satisfy this stress test requirement would be required to (i) conduct an annual stress test of any subsidiary not held under an IHC (except 2(h)(2) companies), either separately or as part of an enterprise-wide stress test, to determine whether the subsidiary has the capital necessary to absorb the results of adverse economic conditions and (ii) submit a report on the test to the FRB on an annual basis.

Early Remediation Framework

The Proposal would establish a mandatory early remediation regime for US operations of foreign banks with $50 billion or more in consolidated global assets.

FBOs with $50 Billion or More in Global and US Assets. These FBOs would be subject to a mandatory early remediation regime precipitated by triggers linked to capital ratios, stress test results, market-based indicators, and risk management weaknesses for both the IHC and the parent FBO.

The remediation could involve four phases: (i) heightened supervisory review (Level 1), in which supervisors conduct a targeted review of the FBO's US operations to determine if it should be moved to the next level of remediation; (ii) initial remediation (Level 2), in which an FBO's US operations are subject to an initial set of remediation measures, including restrictions on growth, acquisitions, and capital distributions; (iii) recovery (Level 3), in which an FBO's US operations are subject to a prohibition on growth, acquisitions, and capital distributions, restrictions on executive compensation, requirements to raise additional capital, and additional requirements on a case-by-case basis; and (iv) recommended resolution (Level 4), in which the FRB would consider whether the FBO's US operations warrant termination or resolution based on the financial decline of the combined US operations, the factors set forth in Section 203 of the Dodd-

Frank Act's Orderly Liquidation Authority (danger of default, adverse effect on financial stability in the United States, no private sector alternative, etc.), and any other relevant factors.

FBOs with $50 Billion or More in Global Assets and Less Than $50 Billion in US Combined Assets. The FRB would also consider these remediation levels in dealing with FBOs that have $50 billion or more in global consolidated assets, but less than $50 billion in combined US assets, on a case-by-case, discretionary basis. In exercising this authority, the FRB would consider the activities, scope of operations, structure, and risk to US financial stability posed by the FBO.

The Proposal provides a detailed approach to applying these triggers and the remediation levels to the IHC and the US branches of the affected FBO. The FRB has also provided a two-page chart (see Tables 2-3, attached) summarizing the Proposal. Other highlights of the early remediation proposal include the following:

- **Market-Based Indicators**. The FRB is considering whether to use market-based indicators as a trigger for early remediation. This could include the use of equity-based indicators (e.g., expected default frequency, market equity ratio, option-implied volatility, and certain debt-based indicators such as credit default swaps and subordinated debt spreads). At this time, the FRB is only considering the use of market-based indicators to trigger the Level 1 heightened supervisory measures.
- **US Branches**. In Level 2 remediation, US branches would be required to maintain a net due-to position to the head office and to non-US affiliates. The US branch network would also be required to maintain its entire liquid asset buffer in the United States. This liquidity requirement would cease to apply were the FBO to become subject to Level 3 remediation.
- **Enforcement Action**. An FBO that is subject to Level 2 remediation would be required to enter into a non-public memorandum of understanding or other enforcement action acceptable to the FRB.
- **Replacement of Officers and Directors**. In Level 3 remediation, the FRB could require the IHC to replace its board of directors or require the IHC to dismiss senior executive officers.
- **Current FRB Authority**. The proposed remediation regime would supplement, not replace, the range of supervisory tools that the FRB currently uses in dealing with financial stress in the US operations of foreign banks.

Effective Date/Timing of Compliance

- As discussed below, FBOs generally will be required to meet the enhanced standards under the Proposal by July 1, 2015.
- For FBOs that have global total consolidated assets of $50 billion or more as of July 1, 2014, the enhanced prudential standards detailed in the Proposal (as applicable, based on the relevant asset thresholds, including the requirement to establish an IHC) would apply starting July 1, 2015.
- FBOs that meet the applicable asset thresholds and become subject to the prudential requirements after July 1, 2014 would be required to establish an IHC, and would become subject to the enhanced prudential standards (other than stress test requirements and the capital plan rule) 12 months after they reach the consolidated asset threshold of $50 billion.
- Stress testing and the capital plan rule would apply in October of the year after an FBO must establish an IHC (i.e., October 2016 for those FBOs required to establish an IHC by July 1, 2015).
- The proposed debt-to-equity limits, which apply if the Financial Stability Oversight Council determines that an FBO with total

consolidated assets of $50 billion or more poses a grave threat to the financial stability of the United States, would apply on the effective date of the final rule.

- A covered FBO must comply with the enhanced prudential standards detailed in the Proposal until its global consolidated (and, as applicable, US) assets remain below the applicable asset thresholds for four consecutive calendar quarters, or until the FBO no longer maintains a US banking presence.

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Endnotes

[1] Foreign banking organizations are defined as foreign banks with US banking operations (including US branches, agencies and bank subsidiaries) and their parent companies. The Proposal is available at http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20121214a.pdf.

[2] See Table 1, attached, which is an expanded version of the chart in the Proposal that summarizes the scope of the application of the Proposal's requirements to FBOs.

[3] A US branch network would be permitted to calculate the liquidity buffer for days 15 to 30 of the stressed horizon based only on external stressed cash flow needs, since, as discussed below, the buffer may be maintained at the parent level.

Table 1: Scope of Application for FBOs

Global Assets	U.S. Assets	SUMMARY OF REQUIREMENTS THAT APPLY	Approx. # of FBOs per category[1]
> $10 billion and < $50 billion	n/a	• Have a U.S. risk committee[2] (can be part of head office governance structure) or face discretionary restrictions on US activities/operations • Meet home country stress test requirements that are broadly consistent with U.S. requirements or comply with 105% asset maintenance requirement for US branches/agencies	29
> $50 billion	< $50 billion	All of the above, plus: • Meet home country risk-based capital standards that are broadly consistent with global Basel III standards (including transition periods) • Single-counterparty credit limits (tied to capital of parent in case of branches/agencies; local capital for IHCs)3 • Subject to an annual company-run liquidity stress test requirement (per BCBS standards) for consolidated FBO or combined US operations only ("noncompliance" results in cap on funding to head office and affiliates of 25% of third party liabilities) • Subject to discretionary DFA section 166 early remediation requirements for failure to meet specified standards • Subject to U.S. intermediate holding company (IHC) requirements (even if BHC): o Required to form U.S. IHC if non-branch U.S. assets exceed $10 billion. All U.S. IHCs are subject to U.S BHC capital requirements, including potential G-SIB surcharges o U.S. IHC with assets between $10 and $50 billion subject to DFA Stress Testing Rule (company-run stress test)	84
> $50 billion	> $50 billion	All of the above, plus: • U.S. IHC with assets >$50 billion subject to capital plan rule and all DFA stress test requirements (CCAR, requiring submission of annual plan to FRB demonstrating ability to meet minimum risk-based capital ratios on stressed basis in order to avoid restrictions on capital distributions) • U.S. IHC and branch/agency network subject to monthly liquidity stress tests (including 30-day stressed liquidity buffer) and separate in-country liquidity requirements (branch/agency network can maintain portion of buffer at head office if demonstrates to FRB ready availability/access) • U.S. risk committee must oversee more formal risk management framework for US operations, meet at least quarterly, and have at least 1 independent member and FBO must have U.S. Chief Risk Officer located in the US who performs designated functions • Subject to non-discretionary DFA section 166 early remediation requirements	23

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1 Approximate number of foreign banking organizations as of September 30, 2012.
2 Applies to FBO's with less than $50 billion in assets only if publicly traded.
3 Foreign banking organizations with assets of $500 billion or more and U.S. IHCs with assets of $500 billion or more would be subject to stricter limits.

Table 2: Early Remediation Triggers for Foreign Banking Organizations

	Risk-Based Capital/Leverage (U.S. IHC)	Risk-Based Capital/Leverage (Parent)	Stress Tests (U.S. IHC)	Enhanced Risk Management and Risk Committee Standards (U.S. combined operations)	Enhanced Liquidity Risk Management Standards (U.S. combined operations)	Market Indicators (Parent or U.S. IHC as applicable)
Level 1 (Heightened Supervisory Review (HSR))	The firm has demonstrated capital structure or capital planning weaknesses, even though the firm: Maintains risk-based capital ratios that exceed all minimum risk-based and requirements established under subpart L by [200-250] basis points or more; or Maintains applicable leverage ratio(s) that exceed all minimum leverage requirements established under subpart L by [75-100] basis points or more.	The firm has demonstrated capital structure or capital planning weaknesses, even though the firm: Maintains risk-based capital ratios that exceed all minimum risk-based and requirements established under subpart L by [200-250] basis points or more; or Maintains an applicable leverage ratio that exceed all minimum leverage requirements established under subpart L by [75-100] basis points or more.	The firm does not comply with the Board's capital plan or stress testing rules, even though regulatory capital ratios exceed minimum requirements under the supervisory stress test severely adverse scenario.	Firm has manifested signs of weakness in meeting enhanced risk management or risk committee requirements.	Firm has manifested signs of weakness in meeting the enhanced liquidity risk management standards.	The median value of any market indicator over the breach period crosses the trigger threshold.
Level 2 (Initial remediation)	Any risk-based capital ratio is less than [200-250] basis points above a minimum applicable risk-based capital requirement established under subpart L; or Any leverage ratio is less than [75-125] basis points above a minimum applicable leverage requirement established under subpart L.	Any risk-based capital ratio is less than [200-250] basis points above a minimum applicable risk-based capital requirement established under subpart L; or Any applicable leverage ratio is less than [75-125] basis points above a minimum applicable leverage requirement established under subpart L.	Under the supervisory stress test severely adverse scenario, the firm's tier 1 common risk-based capital ratio falls below 5% during any quarter of the nine quarter planning horizon.	Firm has demonstrated multiple deficiencies in meeting the enhanced risk management and risk committee requirements.	Firm has demonstrated multiple deficiencies in meeting the enhanced liquidity risk management standards.	n.a.
Level 3 (Recovery)	Any risk-based capital ratio is less than a minimum applicable risk-based capital requirement established under subpart L; or Any applicable leverage ratio is less than a minimum applicable leverage requirement established under subpart L. **Or for two complete consecutive calendar quarters:** Any risk-based capital ratio is less than [200-250] basis points above a minimum applicable risk-based capital requirement established under subpart L; or Any leverage ratio is less than [75-125] basis points above a minimum applicable leverage requirement established under subpart L.	Any risk-based capital ratio is less than a minimum applicable risk-based capital requirement established under subpart L; or Any applicable leverage ratio is less than a minimum applicable leverage requirement established under subpart L. **Or for two complete consecutive calendar quarters:** Any risk-based capital ratio is less than [200-250] basis points above a minimum applicable risk-based capital requirement established under subpart L; or Any leverage ratio is less than [75-125] basis points above a minimum applicable leverage requirement established under subpart L.	Under the severely adverse scenario, the firm's tier 1 common risk-based capital ratio falls below 3% during any quarter of the nine quarter planning horizon.	Firm is in substantial noncompliance with enhanced risk management and risk committee requirements.	Firm is in substantial noncompliance with enhanced liquidity risk management standards.	n.a.
Level 4 (Recommended resolution)	Any risk-based capital ratio is more than [100-250] basis points below a minimum applicable risk-based capital requirement established under subpart L; or Any applicable leverage ratio is more than [50-150] basis points below a minimum applicable leverage requirement established under subpart L.	Any risk-based capital ratio is more than [100-250] basis points below a minimum applicable risk-based capital requirement established under subpart L; or Any applicable leverage ratio is more than [50-150] basis points below a minimum applicable leverage requirement established under subpart L.	n.a.	n.a.	n.a.	n.a.

Table 3: Remediation Actions for Foreign Banking Organizations

<table>
<tr><th></th><th>Risk-Based Capital/Leverage
(U.S. IHC or Parent Level)</th><th>Stress Tests
(U.S. IHC)</th><th>Enhanced Risk Management and Risk Committee Requirements
(U.S. combined operations)</th><th>Enhanced Liquidity Risk Management Standards
(U.S. combined operations)</th><th>Market Indicators
(Parent or U.S. IHC as applicable)</th></tr>
<tr><td>Level 1 (Heightened supervisory review)</td><td colspan="5">For foreign banking organizations with $50 billion or more of global consolidated assets:
The Board will conduct a targeted supervisory review of the combined U.S. operations to evaluate whether the combined U.S. operations are experiencing financial distress or material risk management weaknesses, including with respect to exposures to the foreign banking organization, such that further decline of the combined U.S. operations is probable.</td></tr>
<tr><td>Level 2 (Initial Remediation)</td><td colspan="4">For foreign banking organizations with $50 billion or more in U.S. assets:
○ U.S. IHC capital distributions (e.g., dividends and buybacks) are restricted to no more than 50% of the average of the firm’s net income in the previous two quarters.
○ U.S. branches and agency network must remain in a net due to position to head office and non-U.S. affiliates.
○ U.S. branch and agency network must hold 30-day liquidity buffer in the United States (not required in level 3).
○ U.S. IHC and U.S. branch and agency network face restrictions on growth (no more than 5% growth in total assets or total risk-weighted assets per quarter or per annum), and must obtain prior approval before directly or indirectly acquiring controlling interest in any company.
○ Foreign banking organization must enter into non-public MOU to improve U.S. condition.
○ U.S. IHC and U.S. branch and agency network may be subject to other limitations and conditions on their conduct or activities as the Board deems appropriate.
For foreign banking organizations with less than $50 billion in U.S. assets: Supervisors may undertake some or all of the actions outlined above on a case-by-case basis.</td><td>n.a.</td></tr>
<tr><td>Level 3 (Recovery)</td><td colspan="4">For foreign banking organizations with $50 billion or more in U.S. assets:
○ Foreign banking organization must enter into written agreement that specifying that the U.S. IHC must take appropriate actions to restore its capital to or above the applicable minimum capital requirements and take such other remedial actions as prescribed by the Board
○ U.S. IHC is prohibited from making capital distributions.
○ U.S. branch and agency network must remain in a net due to position to office and non-U.S. affiliates
○ U.S. branch and agency network is subject to a 108% asset maintenance requirement.
○ U.S. IHC and U.S. branch and agency network will be subject to a prohibition on growth, and must obtain prior approval before directly or indirectly acquiring controlling interest in any company.
○ Foreign banking organization and U.S. IHC are prohibited from increasing pay or paying bonus to U.S. senior management
○ U.S. IHC may be required to remove culpable senior management
○ U.S. IHC and U.S. branch and agency network may be subject to other limitations and conditions on their conduct or activities as the Board deems appropriate.
For foreign banking organizations with less than $50 billion in U.S. assets: Supervisors may undertake some or all of the actions outlined above on a case-by-case basis.</td><td>n.a.</td></tr>
<tr><td>Level 4 (Recommended Resolution)</td><td>The Board will consider whether the combined U.S. operations of the foreign banking organization warrant termination or resolution based on the financial decline of the U.S. combined operations, the factors contained in section 203 of the Dodd-Frank Act as applicable, or any other relevant factor. If such a determination is made, the Board will take actions that include recommending to the appropriate financial regulatory agencies that an entity within the U.S. branch or agency network be terminated or that a U.S. subsidiary be resolved.</td><td colspan="3">n.a.</td><td>n.a.</td></tr>
</table>

MAYER • BROWN

Legal Update
December 31, 2012

CFTC Issues a Final, Time-Limited Exemptive Order and Proposes Further Guidance Regarding Cross-border Regulation of Swaps

On December 21, 2012, the US Commodity Futures Trading Commission ("CFTC") issued a release (the "Release")[1] containing a final exemptive order (the "Order") and proposing for public comment additional cross-border guidance (the "Further Proposed Guidance") regarding the cross-border regulation of swaps. The Release represents the latest effort in the CFTC's attempt to meet its statutory mandate to regulate swaps that "have a direct and significant connection with activities in, or effect on, [US] commerce...."[2]

The Order is generally consistent with the proposed exemptive order that the CFTC issued in July 2012 (the "Proposed Order").[3] In brief, the Order, which took effect on December 21, and expires on July 12, 2013, permits swap dealers ("SDs") and major swap participants ("MSPs") who are not "US persons" (as defined below), as well as non-US branches of SDs and MSPs who are US persons, to delay compliance with certain "Transaction-Level Requirements" and, in the case of non-US entities, "Entity-Level Requirements" (both as defined below).[4] The Order adopts a revised interim definition of US person and, among other changes to the SD *de minimis* and MSP threshold calculations for non-US persons, includes a welcome scaling back of certain aggregation requirements. The Order also abandons the Proposed Order's requirement for SDs and MSPs to submit a compliance plan, with unclear impact on the prospects for comparability determinations and substituted compliance.

The Further Proposed Guidance is intended to build upon, but not finalize, the CFTC's cross-border proposal issued in July 2012 (the "July 2012 Proposed Guidance"),[5] issued in conjunction with the Proposed Order. The Further Proposed Guidance includes a proposed alternative definition of US person and an alternative approach to the aggregation requirement for a non-US person's SD *de minimis* calculations (each of which is different from the version adopted on an interim basis in the Order).

The Release includes several other significant interpretive elements and policy statements, including an acknowledgement by the CFTC of market participants' concerns that full compliance with all of the Dodd-Frank swaps requirements may not currently be "practically feasible" given the many interpretive uncertainties and technical and other practical difficulties that must be addressed. As a consequence, the CFTC states that it does not intend to bring any enforcement action against an SD or an MSP for failure to comply with applicable Dodd-Frank swap requirements prior to July 12, 2013, provided that such noncompliance results from practical or technical impediments or interpretive uncertainty, and the registrant "is acting reasonably and in good faith to fully comply with the applicable Dodd-Frank requirements."[6]

The CFTC states in the Adopting Release that this good faith compliance requirement would include:

1. Material progress toward timely implementation and compliance with the Dodd-Frank requirement(s);
2. Identification of any implementation or interpretive issue as soon as reasonably possible;
3. Timely elevation of any such issue(s) to the SD's or MSP's senior management for consideration and resolution; and
4. Timely consultation with other industry participants and the CFTC as necessary to seek resolution of any such issue(s).

The Order shows the CFTC largely unresponsive to the concerns of US SDs that the relative burden of US regulation on them and their customers will render US SDs uncompetitive in many instances. It also does not adopt the recommendations of non-US regulators that more comprehensive deference should be afforded to foreign regulatory regimes.[7] The CFTC also did not respond to the comments that extraterritorial policymaking should be subject to full rulemaking procedures.

The release emphasizes the CFTC's anticipation of continued discussions with foreign and domestic regulators. Accordingly, it is possible that these ongoing discussions will also contribute to further changes in the next phase of the cross-border regulatory regime that will need to be put in place after July 12, 2013, as well as to the ultimate goal of international harmonization.

Public comments on the Further Proposed Guidance s will be due 30 days after publication in the *Federal Register*.

SD and MSP Registration

The CFTC rejected requests from commenters to delay further the registration requirement for non-US SDs and MSPs until final cross-border guidance is adopted, taking the position that such a delay would frustrate the purpose of Dodd-Frank. Accordingly, the Order does not change the timing of registration for non-US entities. However, the Order does provide "targeted, time-limited exemptive relief with respect to the swap dealing transactions to be included in the *de minimis* threshold calculation," which the CFTC believes will "substantially address" industry concerns for the interim period that the Order is in effect. That relief relies, in part, on yet another revised version of the definition of US person.

DEFINITION OF US PERSON UNDER THE ORDER

The Order includes a new definition of US person that will apply (for purposes of the swap provisions of Title VII of Dodd-Frank generally) until the Order expires on July 12, 2013. This definition is based largely on the prior temporary definition of US person adopted by the CFTC in No-Action Letter 12-22 (which is set to expire on December 31, 2012).[8] The principal change from the prior temporary definition is that, beginning on April 1, 2013, a "US person" will include typical forms of business organizations (other than funds or other collective investment vehicles) whose principal place of business is in the United States, in addition to those organizations incorporated or organized in the United States.[9] The Order's definition of US person also includes several technical modifications related to whether pension plans for foreign employees, estates, trusts and joint accounts will be deemed US persons.[10]

- **Non-US Persons; Diligence Requirement.** The Order states that any person not explicitly identified as a US person is a non-US person, addressing commenters' concerns about potential expansion of the definition as it had been originally formulated. In addition, the CFTC has confirmed in the Release that parties may continue to reasonably rely on representations of a counterparty as to its status as a US person or non-US person (as under No-Action Letter 12-22). Such reliance would generally be reasonable in the absence of "red flags" and provided that representations are subject to periodic review. Representations in relationship documentation must be subject to a commitment to update.

- **As Applied to Branches.** In the Release, the CFTC reaffirms its previously stated position that a non-US branch of a US person is a US person, since the branch is not a separate legal entity. The Release recognizes exceptions to this principle, however, with regard to how non-US branches of a US registrant are treated by their counterparties for purposes of the *de minimis* and MSP calculations and, when the branch's counterparty is itself an SD or MSP, the counterparty's compliance with Transaction-Level Requirements (as described below). The CFTC does not discuss the status of US branches of non-US banks, but its adherence to the "single entity" theory reinforces the view that US branches of non-US persons should generally continue to be treated as non-US persons.

DEFINITION OF "US PERSON" UNDER THE FURTHER PROPOSED GUIDANCE

Separate from the interim definition of US person in the Order, the CFTC is requesting comment in the Further Proposed Guidance on proposed modifications to two aspects of the US person definition from the July 2012 Proposed Guidance.

- **Majority-Owned Subsidiaries of Unlimited Liability Parent.** First, the CFTC proposes to define US person to include any non-US entity that is directly or indirectly majority-owned by a natural person resident in the United States or an entity organized, incorporated or having its principal place of business in the United States, if such US person bears "unlimited responsibility for the obligations and liabilities" of the non-US entity. The Release indicates that this aspect of the definition would apply to "unlimited liability corporations" and similar entities that are majority-owned by US persons; it would not include limited liability companies or limited liability partnerships. This prong of the definition also would not cover a legal entity organized or domiciled in a foreign jurisdiction simply because the entity's swap obligations were guaranteed by a US person.
- **Certain Collective Investment Vehicles.** Second, the CFTC proposes to define US person to include a commodity pool, investment fund or other collective investment vehicle (regardless of whether it is organized or incorporated in the United States) that is directly or indirectly majority-owned by one or more US persons, except for any such pool or fund that is publicly traded but not offered to US persons. The exclusion provided for publicly traded collective investment vehicles not offered to US persons is being proposed in response to commenters' concerns regarding the difficulty of verifying the ownership of such publicly traded vehicles.

SD *DE MINIMIS* AND MSP THRESHOLD CALCULATIONS UNDER THE ORDER

Under the Order, a non-US person is not required to include in either its SD *de minimis* calculation or its MSP threshold calculations (i) any swap where the counterparty is not a US person, or (ii) any swap where the counterparty is a non-US branch of a US person that is registered as a SD or represents that it intends to register as a SD by March 31, 2013. The exclusion provided by prong (i) applies regardless of whether the swap obligations of the non-US person testing its SD or MSP status are guaranteed by a US person, thus narrowing the scope of swap transactions that count toward the *de minimis* threshold from that required by the July 2012 Proposed Guidance. The exclusion provided by prong (ii) effectively confirms that the approach to swaps with non-US branches of registered SDs (and those that intend to register) as set forth in No-Action Letter 12-22 will continue to apply, at least for the duration of the Order. This includes the expansion of the exemption for trades with such non-US branches to the MSP calculations (rather than just the SD *de minimis* calculation, as under the July 2012 Proposed Guidance).

- **Denial of Counting Relief for US SDs.** The CFTC specifically rejected the argument of some commenters that US SDs that engage directly in overseas business (i.e., rather than through a non-US branch network) are placed at a competitive disadvantage due to the exemption from the *de minimis* calculation provided to non-US persons for swaps with non-US branches of registered SDs (since non-US persons may shift trading to non-US branches in order to avoid registration). The CFTC did emphasize, however, that a non-US person engaging in a swap with a non-US **affiliate** of a US SD would also be permitted to exclude that transaction from its *de minimis* calculation (regardless of any guarantees that may exist). According to the Release, it is this competitive parity between non-US affiliates and non-US branches of US SDs that supports the exemption afforded the latter. In the CFTC's view, this rationale does not support extending the exemption to US SDs that trade directly with non-US persons.
- **Denial of Specific Relief for Legacy Swaps.** Based on its view that "bright-line tests and categorical exclusions from the term 'swap dealer' … are unwarranted," the CFTC declined to confirm specifically that limited swap activity in furtherance of the unwinding of legacy swap portfolios would not be deemed to be swap dealing. However, the Release does provide that the CFTC "does not intend to preclude its staff from considering appropriate relief in this regard on a case-by-case basis."
- **Central Booking Clarification.** The CFTC clarifies in the Release the discussion in the July 2012 Proposed Guidance regarding the central booking model, in which the CFTC stated that a non-US affiliate or subsidiary of a central booking entity may be required to register as a SD (i.e., in addition to the central booking entity itself) if the non-US affiliate or subsidiary "independently meets the definition of an SD." The Release states that a non-US person in the central booking model would not include in its *de minimis* calculation any swap to which it is not a party (i.e., because the swap is entered into by the central booking entity).

AGGREGATION REQUIREMENT FOR NON-US PERSONS UNDER THE ORDER

Under the July 2012 Proposed Guidance, a non-US person would have been required, for purposes of its SD *de minimis* calculation, to aggregate the US-facing swap dealing transactions of its non-US affiliates. Swap dealing transactions of US affiliates, however, could be excluded. The Order retains for a non-US person engaged in swap dealing with US persons (as of December 21, 2012) the exclusion from aggregation of swap dealing transactions of *US* affiliates, but further scales back the aggregation requirement for a non-US person with respect to the swaps of its *non-US* affiliates, **if** the non-US affiliates are part of a corporate group that includes at least one registered SD.

Specifically, for purposes of the Order, a non-US person that was engaged in swap dealing activities with US persons as of December 21, 2012, and that is an affiliate under common control with a registered SD, is not required to include in its *de minimis* calculation the swaps of any **non-US** affiliate that either was also engaged in swap dealing activities with US persons as of December 21, 2012, or is registered as an SD. Thus, where at least one entity within an affiliated group registers as an SD, another non-US entity within that group generally would be required to register as an SD only if its own swap dealing transactions with US persons, considered individually, exceeded the *de minimis* threshold. Conversely, non-US persons in groups that do not include a registered SD obtain no relief from the requirements to aggregate the US facing swaps of all of their non-US affiliates.

- **Anti-evasion Measure.** As noted above, the relief from the aggregation requirement for swap dealing activities of non-US affiliates is only available for entities that were engaged in swap dealing transaction with US persons as of December 21, 2012 (i.e., the effective date of the Order). The intent of this requirement appears to be to prevent non-US entities from commencing US-facing swap dealing business after December 21 in order to take advantage of the exemption during the temporary relief period. In light of this rationale, it seems that the relief should be interpreted as being available to non-US entities that have swap dealing transactions with US persons on their books as of December 21, 2012, even if such entities have not entered into new swaps with US persons since October 12.

AGGREGATION REQUIREMENT FOR NON-US PERSONS UNDER THE FURTHER PROPOSED GUIDANCE

The CFTC is proposing an alternative interpretation of the aggregation requirement in the Further Proposed Guidance—i.e., one that differs from the approach to aggregation taken in both the July 2012 Proposed Guidance and the Order. Under this alternative approach, a non-US person would be required to include in its *de minimis* calculation the swap dealing transactions of **all** affiliates under common control (i.e., US and non-US), but could exclude the swap dealing transactions of any affiliate that is registered as an SD.[11] Thus, non-US persons within a group that has an affiliated SD could engage in a limited amount of swap dealing activity without being required to register, provided that the aggregate amount of dealing activity conducted by non-registrants in the group did not exceed the *de minimis* threshold. (Under the approach taken to aggregation in the July 2012 Proposed Guidance, such affiliates that are members of a corporate group with a registered SD transacting above the *de minimis* threshold would have been subject to registration for engaging in any US facing swap dealing transactions.)

The CFTC has requested comment on "all aspects" of this proposed alternative approach to aggregation, including whether the interpretation should apply to non-US persons "guaranteed" by a US person and whether the aggregation requirements for non-US persons should include the swap dealing activity of US affiliates.

Substantive Regulation of Non-US SDs and MSPs; Delayed Compliance

The Order classifies SD and MSP regulations into Entity-Level Requirements and Transaction-Level Requirements that are the same as in the Proposed Order.[12]

- **Entity-Level Requirements.** These consist of: (i) capital adequacy; (ii) chief compliance officer; (iii) risk management; (iv) swap data recordkeeping; (v) swap data reporting ("SDR Reporting"); and (vi) large-trader reporting for physical commodity swaps reporting ("LTR"). The Release lists the specific CFTC regulations that correspond to Entity-Level Requirements as CFTC regulations 1.31, 3.3, 23.201, 23.203, 23.600-603, 23.605-609 and Parts 20, 45 and 46.
- **Transaction-Level Requirements.** These consist of: (i) clearing and swap processing; (ii) margining and segregation for uncleared swaps; (iii) trade execution; (iv) swap trading relationship documentation; (v) portfolio reconciliation and compression; (vi) real-time public reporting; (vii) trade confirmation; (viii) daily trading records; and (ix) external business conduct standards. The Release lists the specific provisions of the CEA and CFTC regulations that correspond to Transaction-Level Requirements as CEA section 2(h)(8)

and CFTC regulations 23.202, 23.400-451, 23.501-503, 23.504(a), (b)(2), (b)(3) and (b)(4), 23.505(b)(1), 23.506, 23.610 and Part 43.

- **Pending Requirements.** Neither the CFTC, the SEC nor the banking agencies have adopted final rules for capital adequacy, an Entity-Level Requirement, or for the Transaction-Level Requirements relating to margin and segregation of uncleared swaps and trade execution. These requirements are outside the scope of the Order. Should CFTC final rules for any of these requirements come into effect prior to the expiration of the Order, the CFTC will consider extending the Order to such requirements at that time.

RELIEF FROM ENTITY- AND TRANSACTION-LEVEL REQUIREMENTS FOR NON-US REGISTRANTS AND NON-US BRANCHES

The Order generally allows non-US SDs and MSPs to delay compliance with Entity-Level Requirements that are in effect as of the effective date of the Order. With respect to SDR Reporting and LTR, however, the Order provides more limited relief. A non-US SD or MSP may delay compliance with SDR Reporting and LTR only with respect to swaps with non-US counterparties, and only if the non-US SD or MSP is **not** part of an affiliated group in which the ultimate parent entity is a US SD or MSP, US bank, US financial holding company or US bank holding company. The Order does not permit SDs or MSPs (whether US or non-US) to delay compliance with SDR Reporting or LTR for swaps with US counterparties, including non-US branches of US persons. Nor does it excuse US SDs or MSPs from compliance with any other Entity-Level Requirements.

The Order does not affect the obligation of an SD or an MSP to comply with Transaction-Level Requirements for swaps with US counterparties. For swaps with non-US counterparties, non-US SDs and MSPs and non-US branches of US SDs and MSPs may comply with such requirements only as may be required by the local jurisdiction of the non-US registrant or branch. In addition, for swaps between non-US branches of US SDs and MSPs, non-US branches may comply with such requirements only as may be required by the local jurisdiction of such branches. For purposes of the relief relating to swaps between non-US branches of US persons, a swap is considered to be with the non-US branch of a US person when (i) the personnel negotiating and agreeing to the terms of the swap are located in the jurisdiction of the branch, (ii) the documentation of the swap specifies that the counterpart or "office" for the US person is such non-US branch and (iii) the swap is entered into by the non-US branch in its normal course of business. Unlike the Proposed Order, the Order does not treat external business conduct requirements separately from other Transaction Level Requirements.

The CFTC clarifies in the Release that a non-US SD may treat the non-US branch of a US registrant as a non-US person for purposes of the Order's relief from Transaction-Level Requirements.

- **Denial of Parity for US SDs.** The CFTC rejected requests from many commenters who had sought, in various forms, extension of the relief granted to non-US SDs and MSPs and non-US branches of such registrants to US SDs and MSPs dealing with non-US counterparties. According to the CFTC, extension of relief from the substantive regulation of SDs and MSPs to US registrants would be contrary to the requirements of the Dodd-Frank Act and the CFTC's supervisory interest in swap activities occurring in the United States. The CFTC states its view in the Adopting Release that issues of "regulatory disparity" among jurisdictions will be best addressed by working with non-US regulatory bodies to enhance and harmonize standards in other jurisdictions.

Commenters had pointed out difficulties posed in the cross-border context by CFTC requirements applicable to principals and associated persons of a non-US SD or MSP. The CFTC declined to grant relief in the Order from such requirements, stating that it believes staff action to be the more appropriate vehicle for such relief.[13]

Privacy and Confidentiality Laws

A number of commenters called attention to the potential for conflicts between Dodd-Frank requirements and local privacy and data protection laws, in particular with regard to SDR Reporting, LTR and US regulators' access to registrants' books and records. Although the CFTC did not address such conflicts in the Order directly, the Release cites other mitigating actions taken by the CFTC and its staff. The CFTC states that it is revising its Form 7-R (the registration application form) by making the agreement therein that foreign firms produce books and records upon CFTC request subject to the provisions of any applicable blocking, privacy or secrecy laws. Although the CFTC states in the Release that it intends to exercise its access and examination rights regardless of a registrant's location, it further states that it will endeavor to achieve an understanding with each relevant regulator and that it believes such a "balanced and flexible approach" will allow it to achieve access to information "in a manner designed to ensure continuing cooperative relationships with its counterparts overseas."

In addition, the CFTC cites a recent staff no-action letter, issued in response to a request from the International Swaps and Derivatives Association Inc., which permits certain counterparty identifying information to be omitted from SDR Reporting and LTR reports, subject to the conditions and time limitations stated in the letter.[14]

Concluding Observations

While the relief afforded in the Order will be significant for some non-US entities (particularly those that are part of a corporate group that includes a registered SD), it has much less to offer US swap market participants. The CFTC was largely unreceptive to the arguments made by a number of commenters that certain aspects of the exemptive relief provided by the Order should be extended to US SDs and MSPs.

In any case, the Order represents yet another temporary measure for market participants to contend with and does not provide the final word on any aspect of the CFTC's regulation of cross-border swap activities. Nevertheless, for non-US swap market participants currently engaged in SD *de minimis* and MSP threshold calculations to determine whether they may be required to register with the CFTC, the Order provides the (temporary) operative guidance with respect to which swaps will be included in those calculations.[15]

Additional certainty for domestic and non-US swap market participants will likely be available only after the cross-border guidance is finalized, which is subject to the CFTC's ongoing efforts to coordinate with domestic and non-US regulators, and will also need to take into account public comments on the newly issued Further Proposed Guidance. Those comments will be due 30 days after publication of the Further Proposed Guidance in the *Federal Register*.

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Endnotes

1 Available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister122112.pdf

2 Commodity Exchange Act § 2(i), added by Section 722(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").

3 77 Fed. Reg. 41110 (July 12, 2012). For more information, see our Legal Update "CFTC Proposes Phased Compliance Program for Certain Swaps," available at http://www.mayerbrown.com/CFTC-Proposes-Phased-Compliance-Program-for-Certain-Swaps/.

4 For purposes of this update, SD and MSP are used to refer to persons who are registered with the CFTC as SDs or MSPs.

5 77 Fed. Reg. 41214 (July 12, 2012). For more information, see our Legal Update "Proposed CFTC Guidance Regarding the Cross-Border Application of US Swap Regulations," available at http://www.mayerbrown.com/Proposed-CFTC-Guidance-Regarding-the-Cross-Border-Application-of-US-Swaps-Regulations-07-02-2012/.

6 By its terms, the CFTC's statement of a relaxed enforcement policy applies only to SDs and MSPs. The statement does not refer to non-SDs/MSPs, including those entities that may be in the process of resolving various "interpretive uncertainties" with respect to whether they are required to register. However, in light of rationale underlying the CFTC's stated approach to enforcement, we would expect non-registrants to be accorded the same treatment, subject to the same good faith obligations.

7 The CFTC's deferral for non-US entities of certain aspects of compliance provides some accommodation to international comity and the practical difficulties faced by non-US entities. This selective and temporary CFTC approach to early compliance remains very problematical, however, for international market participants desirous of an international accord and level playing field. Requiring non-US entities to register in advance of such an accord is but one facet of the uncomfortable distribution of "equities" accompanying the CFTC effort to preserve compliance deadlines ahead of other nations.

8 Until December 31, 2012, market participants have the option of applying either the definition of "US person" included in No-Action Letter 12-22 or the definition in the Order. Beginning on January 1, 2013, the Order version is mandatory.

9 The CFTC declined to extend this "principal place of business" prong of the definition to funds and collective investment vehicles for purposes of the Order in light of the complexities of applying the test to these entities.

10 Pension plans that are "primarily" for foreign employees are excluded from the US person definition. Joint accounts where one of the beneficial owners is a US person are included. Trusts are referred to in *both* (i) the prong of the US person definition that considers jurisdiction of organization and (after April 1, 2013) principal place of business and (ii) a separate prong for estates and trusts, which requires that the trust be governed by the laws of a state or other jurisdiction in the United States and subject to the primary supervision of a US court to be considered a US person. The intended interaction between the two prongs for trusts is unclear.

11 Swap dealing transactions of the non-US person and its non-US affiliates would continue to count against the threshold only if the counterparty is a US person.

12 The Order classifies the SD/MSP requirements in the same manner as the Proposed Order. The CFTC intends to consider any reclassification of these requirements in connection with further guidance on cross-border issues.

13 See, e.g., CFTC Letter No. 12-49 (conditional relief from fingerprinting requirement for principals who have not resided in the United States since reaching 18 years of age). The Division of Swap Dealer and Intermediary Oversight notes in the letter that it will continue to explore alternatives to the fingerprinting requirement in the context of non-US principals and may in the future revisit the process described in the letter.

14 CFTC Letter No. 12-46. Among other conditions, the no-action relief requires the reporting party to make certain determinations regarding privacy law conflicts based on a "written opinion of outside legal counsel" and to make reasonable and demonstrable efforts (including direct efforts) to obtain non-reporting party consent or regulatory authorization, as applicable, to disclose the omitted information. See also Press Release PR6479-12 (December 21, 2012) (available at http://www.cftc.gov/PressRoom/

PressReleases/pr6479-12). Mayer Brown is pleased to have been able to assist ISDA in its request for this relief.

[15] We note that CFTC staff has issued numerous no-action letters that provide exclusions for certain categories of swap transactions from those that must be counted toward the *de minimis* thresholds. See, e.g., CFTC Letters 12-16, 12-18, 12-20, 12-21, 12-22, 12-57, 12-60, 12-61, 12-62. The relief is time-limited, with various expiration dates applying.

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Legal Update
December 10, 2012

CFTC Further Clarifies Commodity Pool Treatment for Certain Securitizations and Provides Additional No-Action Relief for Others

On December 7, 2012, the Division of Swap Dealer and Intermediary Oversight (Division) of the Commodity Futures Trading Commission (CFTC) issued interpretation and no-action letter No. 12-45,[1] "Further Exclusions from Commodity Pool Regulation for Certain Securitization Vehicles; No-Action Relief for Certain Securitization Vehicles Formed Prior to October 12, 2012" (the CFTC Second Securitization Letter). The CFTC Second Securitization Letter does three things: it provides interpretive clarification that some securitization entities are not "commodity pools"; it provides conditional no-action relief for certain legacy securitization entities; and it provides time-limited no-action relief until March 31, 2013 for non-exempt securitization entities to allow for more time for further dialogue with CFTC Staff.

Further Clarification and Interpretation

The CFTC Second Securitization Letter begins by affirming the relief provided by the Division in CFTC Interpretation Letter No. 12-14[2] (the CFTC First Securitization Interpretation Letter, which we discussed in our related prior Legal Update[3]). It then discusses some additional types of securitization entities that the Division has determined generally should be excluded from the definition of "commodity pool," even though such entities may not meet the operating or trading limitations contained in Regulation AB under the Securities Exchange Act of 1934, as amended (Regulation AB), and Rule 3a-7 under the Investment Company Act of 1940, as amended (Rule 3a-7), as required under the CFTC First Securitization Interpretation Letter. These securitization entities would properly be excluded if (i) they otherwise meet the requirements that the use of swaps is no greater than contemplated by Regulation AB or Rule 3a-7, (ii) the swaps used by such entities are not used in any way to create an investment exposure and (iii) the criterion relating to the ownership of financial assets under the CFTC First Securitization Interpretation Letter continues to be satisfied. In the Division's view, investments in such an entity are essentially in the financial assets held by the entity and not in the swaps, much like investments in traditional securitization vehicles that satisfy Regulation AB or Rule 3a-7.

Clarifications With Respect to Certain Securitization Vehicles

Specifically, the Division cites standard asset-backed commercial paper (ABCP) conduits, traditional collateralized debt obligation (CDO) and covered bond transactions as examples of such securitization entities.

In cases where exposures to synthetic assets consisting of swaps are designed to create, or have the effect of creating, investment exposure (i.e., that may increase investment returns and distributions rather than serving as credit enhancement as contemplated by Item 1114[4] of Regulation AB or a permitted form of hedging under Regulation AB), such vehicles may be a commodity pool; however, the Division notes that, depending on additional facts, the operator of a CDO or other securitization entity with a small portion of its holdings in synthetic assets may be exempt under CFTC Regulation 4.13(a)(3).

Securitization Entities To Which the Safe Harbor Does Not Apply

The CFTC Second Securitization Letter also discusses additional securitization entities that, in the Division's view, are distinguishable and are not similarly exempt. These entities include repackaging vehicles that either (i) issue credit- or equity-linked securities and hold high-quality financial assets, but sell credit protection through a swap, through which the related investors obtain their investment exposure or (ii) use swaps to extend the investment maturity on an underlying bond. In these cases, the Division's view is that investors are obtaining a significant component of their investment upside or downside from the related swaps.

Is There a Broader Principle?

The CFTC, in effect, is perhaps endorsing a broader principle: that a securitization entity would not be treated as a commodity pool if the swaps do not create an "investment exposure." An investment appears to be treated as an "investment exposure" if its return would be variable depending on the variability of the payment requirements under the swaps. This principle would appear to exempt from the definition of "commodity pool" any typical securitization entity that issues only securities that have a stated return and for which the swaps are relatively precise hedges of interest rate and currency risks.

No-Action Relief

The CFTC Second Securitization Letter includes both no-action and time-limited no-action relief for operators of securitization vehicles.

First, the Division states that no enforcement action will be taken for failure to register as a commodity pool operator (CPO), if the following criteria are and remain satisfied:

- The issuer issued fixed income securities before October 12, 2012 that are backed by, and structured to be paid from, payments on or proceeds received in respect of, and whose creditworthiness primarily depends upon, cash or synthetic assets owned by the issuer;
- The issuer has not and will not issue new securities on or after October 12, 2012; and
- The issuer shall, promptly upon request of the Commission or any division or office thereof, and in any event within 5 business days of such request, provide to such requestor an electronic copy of the following:
  - the most recent disclosure document used in connection with the offering of the related securities;
  - all amendments to the principal documents since issue;
  - the most recent distribution statement to investors: and
  - if the issuer's securities were offered relying on Rule 144A under the Securities Act of 1933, a copy of the information that would be provided to prospective investors to satisfy Rule 144A(d)(4); *provided*, that, if the issuer does not provide the information required under the CFTC Second Securitization Letter, it must demonstrate that it cannot obtain the required documents through reasonable commercial efforts.

As a result, unexcused failure to provide such required documentation would result in the related securitization entity becoming ineligible to rely on the relief granted in the CFTC Second Securitization Letter.

Second, the CFTC Second Securitization Letter also includes time-limited no-action relief until March 31, 2013, for operators of securitization entities that are not entitled to the relief under the CFTC First Securitization Interpretation Letter, or otherwise under the CFTC Second Securitization Letter, because they failed to register as CPOs. The relief allows for continuing dialogue between the CFTC and the securitization industry.

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Endnotes

1 Available at http://cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-45.pdf.

2 Available at http://cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-14.pdf.

3 Available at http://www.mayerbrown.com/CFTC-Clarifies-Commodity-Pool-Treatment-for-Certain-Securitizations-and-Provides-Time-Limited-No-Action-Relief-for-Others-10-19-2012/.

4 The Division noted that where the use of swaps is commercially unreasonable as credit support with respect to a securitization, it may conclude that a commodity pool exists. By way of example, the Division discussed the use of a swap by an issuer with an affiliate/sponsor where the swap counterparty credit support for the interest and principal was sufficient to allow the floating rate bonds rated “CCC” to obtain “AA” pricing. Such vehicle would be a commodity pool, in the Division’s view, because the swap was a significant aspect of the investment.

Proposed CFTC Guidance Regarding the Cross-Border Application of US Swap Regulations

On Friday, June 29, 2012, the US Commodity Futures Trading Commission (the "CFTC") released its proposed interpretive guidance and policy statement (the "Proposed Guidance") regarding the cross-border application of the swaps provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[1] The Proposed Guidance complements the recent adoption by the CFTC and the US Securities and Exchange Commission (the "SEC") of their joint final rules (the "Final Entities Rulemaking") further defining the terms "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," and "Major Security-Based Swap Participant," all of which were added to the Commodity Exchange Act (the "CEA") and the Securities Exchange Act of 1934 by the Dodd-Frank Act.[2] The Proposed Guidance addresses both (i) when non-US persons, including legal entities, must register as a swap dealer or major swap participant ("MSP"), and (ii) the extent to which a non-US person will be subject to the substantive regulatory requirements applicable to registered swap dealers and MSPs.

We identify and summarize below key aspects of the Proposed Guidance, including page references to the version of the Proposed Guidance posted on the CFTC's website. Comments on the Proposed Guidance are due 45 days after publication in the Federal Register, which is expected shortly. The SEC has announced plans to issue its separate release on cross-border issues for security-based swap dealers and major security-based swap participants later this summer.

Even before it was released, the Proposed Guidance was already controversial and is likely to generate substantial comment. The CFTC's public meeting to discuss and approve the guidance was cancelled almost two weeks ago because of the lack of consensus among the Commissioners. Both of the Republican Commissioners, Scott O'Malia and Jill Sommers, issued "concurring statements" supporting the issuance of the proposed guidance in order to begin a public dialogue, but also raising significant concerns about it. Among the themes they raise are the lack of full rulemaking process (e.g., the lack of any cost-benefit analysis), inadequate coordination with the SEC on its companion cross-border release and with non-US regulators, a continued overreach by the CFTC in interpreting the extraterritorial application of Title VII, a vague approach to comparability determinations for non-US regulatory systems, and lack of fair treatment of US market participants.

In connection with the Proposed Guidance, the CFTC also released a proposed exemptive order (the "Proposed Order") that would conditionally permit swap dealers and MSPs that are not US persons (as defined in the Proposed Guidance) to: (i) defer compliance with certain swap Entity-Level Requirements (as defined below) until 12 months after publication of the

Proposed Order; and (ii) satisfy certain swap Transaction-Level Requirements (as defined below) through so-called "substituted compliance" with applicable non-US law.[3] The Proposed Order would not, however, delay swap dealer and MSP registration deadlines for non-US persons. We will be covering the Proposed Order in a separate Legal Update.

Definition of "US Person"

General Definition. Much of the Proposed Guidance is dependent upon whether one or both parties to a swap transaction is a "US person." Many earlier commenters had proposed that the CFTC adopt the SEC's Regulation S definition of US person. The CFTC rejected this suggestion, instead proposing to define US person as including, without being limited to, the following:[4]

1. any natural person who is a US resident;
2. any corporation, partnership, limited liability company, trust, association, joint-stock company, fund, or any similar enterprise (A) that is organized or incorporated under US law or has its principal place of business in the United States, or (B) the direct or indirect owners of which are responsible for liabilities of the enterprise and one or more of such owners is a US person;
3. any individual account (discretionary or not) where the beneficial owner is a US person;
4. any commodity pool, pooled account, or collective investment vehicle (whether or not organized in the United States) that is directly or indirectly majority-owned by US persons;
5. any commodity pool, pooled account, or collective investment vehicle the operator of which would be required to register with the CFTC as a commodity pool operator;
6. a pension plan for the employees, officers, or principals of a legal entity with its principal place of business in the United States; and
7. any estate or trust, the income of which is subject to US income tax (16).

Non-US Branches of US Persons. The Proposed Guidance expressly provides that a non-US branch or agency of a US person would be covered by the "US person" definition because the branch or agency "is a part, or an extension, of a US person" (16).

Non-US Subsidiaries and Affiliates of US Persons. The Proposed Guidance states that a non-US affiliate or subsidiary of a US person would not be within the scope of the definition, even if all swap-related obligations of such affiliate or subsidiary are guaranteed by a US person (16). The Proposed Guidance does not reconcile this statement with prong (2.) of the "US person" definition set forth above, which seems to provide that a non-US company guaranteed as to liabilities by its US owner is a US person. However, the CFTC states that it is considering, and seeks comment on, whether the definition of "US person" should be expanded to include a non-US affiliate or subsidiary that is guaranteed by a US person (16).

Non-US Persons. "Non-US person" is not formally defined in the Proposed Guidance. While logical, it is not clear that it would be defined as any person who is not a US person. Presumably a non-US bank with a US branch or agency would be treated as a non-US person.

Swap Dealer *De Minimis* Calculation for Non-US Persons

Under the Final Entities Rulemaking, a person that engages in more than a *de minimis* level of swap dealing generally would be required to register as a Swap Dealer. However, under the Proposed Guidance, a non-US person would only count swap transactions with US persons under the *de minimis* test. The Proposed Guidance modifies this general test in the following additional ways.

Exclusion for Swaps with Non-US Branches of US Swap Dealers. In determining whether its swap dealing activities exceed the *de minimis* threshold, a non-US person would not include dealing transactions with non-US branches of registered US swap dealers, e.g., the London branch of a US bank that had registered as a swap dealer (21).

Aggregation Rules. A non-US person would include in its *de minimis* calculations the swap dealing transactions with US persons of all of its non-US affiliates under common control and any swap dealing transactions of non-US affiliates under common control the obligations of which are guaranteed by a US person (21-22). However, swap dealing transactions of affiliated US persons would not be included in the *de minimis* calculation (22). The Proposed Guidance does not expressly state whether a non-US bank should aggregate the swap dealing activities of its US branch or agency for these purposes. However, in light of the CFTC's apparent rejection of the argument that a US branch of a non-US bank is a separate legal entity subject to independent swap dealer registration (discussed further below), it would appear that the swap dealing activities of a non-US bank for purposes of the *de minimis* calculation would be deemed to include swaps of its US branch or agency, at least with US counterparties.

Guarantee Relationships. A non-US person (e.g., a non-US subsidiary of a US bank) must include any swap dealing transactions where its obligations (or the obligations of its non-US affiliate) are guaranteed by a US person, such as its US parent bank. This includes swap dealing transactions with non-US counterparties that would not otherwise be included (26-27).

Inter-Affiliate Swaps. A non-US person would not include transactions with its US affiliates that are majority-owned. The Proposed Guidance does not address transactions between a non-US bank and its US branch, but presumably these would also not be included (20-21, FN 43).

MSP Threshold Calculations for Non-US Persons

Similarly, the MSP thresholds established under the Final Entities Rulemaking are modified for non-US persons. In particular, a non-US person who is not a swap dealer must only count swap positions with counterparties who are US persons when assessing whether MSP registration is required (24). That is, swap positions with a counterparty who is not a US person are generally not included in determining whether a non-US person's swap positions exceed the MSP thresholds.

Swaps with Non-US Branches of US Persons. The Proposed Guidance does not provide any exclusion for swaps between a non-US person and the non-US branch of a US person for purposes of the MSP threshold calculations, including non-US branches of registered US swap dealers. Accordingly, a non-US person would be required to count its swap positions where a non-US branch of a US person is the counterparty, even if the US person is a swap dealer. The CFTC has requested comment on whether the proposed exclusion of swaps with non-US branches of registered US swap dealers that would apply in the context of swap dealer *de minimis* calculations should also apply for purposes of MSP threshold calculations (32).

Swaps with Non-US Persons Guaranteed by US Persons. Unlike for purposes of the swap dealer *de minimis* calculation, a non-US person would exclude from its MSP threshold calculations any swap positions with a US counterparty where the obligations of the non-

US person are guaranteed by a US person (26-27). In such cases, the swap position is instead attributed to the US guarantor. A non-US person would include in its MSP threshold calculations any guarantees it provides with respect to the obligations of another non-US person in a swap transaction with a US person (28).

Treatment of Branches and Agencies for Registration Purposes

Non-US Branches and Agencies of US Banks. Under the Proposed Guidance, swap dealer and MSP registration requirements for US persons would apply to banks at the principal entity level—i.e., non-US branches and agencies of US banks would not separately register (28).

US Branches and Agencies of Non-US Banks. The Proposed Guidance does not directly address how swap dealer and MSP registration and related requirements would apply to the US branches and agencies of non-US banks. The CFTC begins to address the question of whether US branches could be eligible for registration and regulation on an independent basis, but does not provide a clear answer (29-30, FN 54). Instead, in footnote 54 of the Proposed Guidance, the CFTC directs readers to further discussion of this issue in a "subsection E," which does not appear in the published text of the Proposed Guidance. Based on the treatment of non-US branches of US banks and the CFTC's apparent rejection of the argument that branches should be treated as separate legal entities, it seems unlikely that US branches of non-US banks would be eligible to register as swap dealers or MSPs. However, the lack of clear guidance on this point and the possibility that the CFTC elected to strike further clarification during the editing process may signal a lack of consensus among the Commissioners.

Application of Entity-Level and Transaction-Level Requirements to Swap Dealers and MSPs That Are Not US Persons

In determining whether and to what extent Title VII will apply extraterritorially, the CFTC proposes to divide these provisions conceptually into (i) "Entity-Level Requirements," which apply to a swap dealer or MSP on a firm-wide basis and (ii) "Transaction-Level Requirements," which apply to an individual swap (36).[5]

- **Entity-Level Requirements:** capital adequacy; chief compliance officer; risk management; swap data recordkeeping; swap data reporting ("SDR Reporting"); and physical commodity swaps reporting ("Large Trader Reporting") (37-43).
- **Transaction-Level Requirements:** clearing and swap processing; margining and segregation for uncleared swaps; trade execution; swap trading relationship documentation; portfolio reconciliation and compression; real-time public reporting; trade confirmation; daily trading records; and external business conduct standards (43-49).

Applicability of Entity-Level Requirements. The Proposed Guidance would require that swap dealers and MSPs that are not US persons comply with all Entity-Level Requirements, subject to the potential availability of "substituted compliance" with non-US regulation, as discussed below (50).

Applicability of Transaction-Level Requirements – US Counterparties. Swap dealers and MSPs that are not US persons would generally be required to comply with Transaction-Level Requirements only for swaps with US persons as counterparties (excluding the non-US branches of US persons) (52,55). Substituted compliance generally would not be available for these requirements.

Applicability of Transaction-Level Requirements – Non-US Counterparties. Swap dealers and MSPs that are non-US persons would not be required to comply with Transaction-Level Requirements for swaps with non-US counterparties unless the performance of the non-US counterparty is guaranteed (or otherwise supported) by a US person (55). Compliance generally would be required in the case of such guaranteed transactions (except with respect to the external business conduct standards, which would never apply to the swaps of a swap dealer or MSP that is not a US person with a non-US counterparty) (55-56). Substituted compliance would generally be permitted for swaps with a non-US person guaranteed by a US person (53-55, 59).

Conduits for US Persons. Notwithstanding that Transaction-Level Requirements generally would not apply to swaps between a swap dealer or MSP that is a non-US person and a non-US counterparty (unless there is US guarantor), the Proposed Guidance includes a special rule that would impose these requirements on transactions with non-US "conduits" for US persons. Under this rule, the Transaction-Level Requirements would apply to swaps with a non-US person where: (i) the non-US person is majority-owned by a US person, (ii) the non-US person regularly enters into swaps with other US affiliates or subsidiaries of the US person, and (iii) the non-US person is consolidated with the US person for financial statement purposes (55). Substituted compliance may be permitted.

Substituted Compliance with Non-US Swaps Regulation by Swap Dealers and MSPs Who Are Not US Persons

Under the Proposed Guidance, a swap dealer or MSP that is not a US person would be permitted, under certain circumstances, to conduct business in compliance with home country regulations without satisfying additional requirements arising under US law (56-57). This substituted compliance would only be available upon a specific finding by the CFTC that the non-US home country requirements are "comparable to cognate requirements under the CEA and [CFTC] regulations" (57). The CFTC proposes to make such comparability determinations on an individual requirement basis—i.e., not as to non-US regimes as a whole (57).

Entity-Level Requirements. The CFTC proposes to permit substituted compliance with respect to all Entity-Level Requirements where swap dealers or MSPs that are not US persons are subject to comparable non-US home-country regulation (58). Under this framework, a swap dealer or MSP that is not a US person would be permitted to meet its SDR reporting obligations by reporting to a non-US trade repository, but only if the CFTC has direct access to swap data stored with the non-US repository (58).

Transaction-Level Requirements. Substituted compliance generally would not be available for transactions by a swap dealer or MSP that is not a US person with a counterparty that is a US person (59). However, substituted compliance for Transaction-Level Requirements would be permitted for swaps with a non-US person guaranteed by a US person or a non-US person that is a "conduit" for a US person (59).

Comparability Determinations. Before a swap dealer or MSP that is a non-US person may rely on substituted compliance, the CFTC must make a comparability and comprehensiveness determination with respect to the relevant laws and regulations of the non-US jurisdiction (68-69). The Proposed Guidance sets forth in general terms the procedure by which non-US persons—either individually, in connection with a swap dealer or MSP application, or as part of a group of non-US persons from the same jurisdiction—may apply to the CFTC to be permitted to rely on substituted compliance (70-72). The Proposed Guidance also notes that non-US regulators may apply on behalf of persons subject to their jurisdiction (70). The CFTC anticipates the use of MOUs to establish protocols for information-sharing and cooperation as to swap dealer and MSP supervision (71-72).

Application of Swap Provisions to Non-US Branches, Agencies, Affiliates and Subsidiaries of US Swap Dealers

Non-US Branches and Agencies. Because the non-US branch or agency of a US swap dealer is deemed part of that US person, the swap dealer would be responsible for compliance with all applicable Entity-Level Requirements for the swap dealing activities of its non-US branches and agencies (60). Under the Proposed Guidance, swaps entered into by a US person through a non-US branch or agency would also be subject to the Transaction-Level Requirements, regardless of whether the counterparty is a US person or non-US person (except for the external business conduct standards, which apply only in the case of US counterparties) (60).

Non-US Branches and Agencies – Substituted Compliance. The Proposed Guidance would permit substituted compliance with non-US regulatory requirements of the host jurisdiction by a non-US branch or agency for swaps with its non-US counterparties, subject to the required CFTC comparability determinations (60-61). Moreover, the Proposed Guidance would permit non-US branches and agencies of US swap dealers to participate in the swap markets in "emerging market" countries, subject to quantitative limits, any transaction-level requirements applicable in those non-US jurisdictions and certain additional recordkeeping and risk management requirements (61,62).

Non-US Subsidiaries and Affiliates. The applicability of swap provisions to the non-US subsidiaries and affiliates of a US swap dealer turns on where swaps are booked and whether the non-US affiliate or subsidiary independently triggers the swap dealer registration requirement. Thus, swap dealer regulations would not apply to a non-US subsidiary or affiliate acting as a disclosed agent on behalf of the US swap dealer, provided that the non-US person does not itself trigger the swap dealer definition (63). Non-US subsidiaries and affiliates that enter into swaps that are not directly booked at the US swap dealer are treated in a manner consistent with other non-US persons (64).

Swap Transactions of Other Market Participants That Are Not US Persons

Swaps Between Non-US Persons. Where a non-US person enters into a swap with another non-US person outside the United States and neither counterparty is required to register as a swap dealer or MSP, the swap generally would not be subject to swap regulations arising under Title VII of the Dodd-Frank Act (75).

Swaps Between a US Person and Non-US Person. Under the Proposed Guidance, swaps involving at least one party that is a US person would be subject to Title VII requirements relating to clearing, trade-execution, real-time public reporting, Large Trader Reporting, SDR Reporting, and recordkeeping (i.e., those swap provisions that apply to counterparties other than swap dealers and MSPs).

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Endnotes

[1] The Proposed Guidance, which is subject to technical correction prior to Federal Register publication, is available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister062912.pdf.

[2] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 Fed. Reg. 30596 (May 23, 2012). A Mayer Brown Legal Update analyzing the Final Entities Rulemaking is available here.

[3] A copy of the Proposed Order is available from the CFTC website at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister062912b.pdf.

[4] The CFTC's election to propose an apparently non-exhaustive list of persons that would be US persons, rather than a complete formal definition of the term, creates uncertainty that will hopefully be better addressed in final guidance.

[5] Please note that swap dealers and MSPs that are subject to the capital and margin regulations of a "prudential regulator" such as the Board of Governors of the Federal Reserve System or the Office of the Comptroller of the Currency would be subject to the "cross-border" approach contained in those regulations, not to the CFTC's Proposed Guidance. Thus, non-US banks with US branches or agencies and the non-US branches of US banks will be subject to those prudential regulations, when they are adopted in final form, with respect to capital and margin requirements (38-39, FN 67).

Tab 10

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