Understanding the New Financial Reform Legislation: The Dodd-Frank Wall Street Reform and Consumer Protection Act

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THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

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THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

A. Summary

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) is historic and game-changing financial services legislation of the sort that is only seen once in a great while. Precipitated by the financial crisis that began in 2007, it represents the culmination of many months of intense legislative and executive branch effort, and will have a sweeping impact on the delivery of financial services in the United States, and on the organization, financial condition, and operations of domestic and international banks and bank holding companies (BHCs), securities firms, insurance companies, and other providers of financial services in the United States and around the world.

Nevertheless, the Dodd-Frank Act is not as ambitious in its coverage as some proposed in the immediate aftermath of the crisis. Notably, the legislation does nothing to reform the secondary mortgage market operations of Fannie Mae and Freddie Mac. Moreover, the Dodd-Frank Act largely avoids the issue of comprehensive regulatory restructuring, effectively leaving untouched the existing hodgepodge of federal regulatory authorities, except that it abolishes the Office of Thrift Supervision (OTS), while creating yet another federal financial authority, a new financial consumer regulatory body that will have broad authority over US consumer financial services activities. Even so, the new legislation is substantial in its length, far-reaching in its effects and will likely lead to major changes in the regulation of financial services activities and how those activities are conducted by domestic and international market participants.

B. A Very Brief History of the Legislation

The Dodd-Frank Act is the outcome of a legislative process that began in the fall of 2008, during the height of the financial crisis and the enactment at that time of the Emergency Economic Stabilization Act (EESA) which, among other things, created the Troubled Asset Relief Program (TARP) fund. The Obama Administration developed and released what it considered to be a plan for comprehensive regulatory reform in June 2009 and publicized a series of legislative proposals to carry out the plan in the months that followed. Both houses of Congress undertook a review of the Administration’s proposals but also proceeded to introduce their own versions of financial services regulatory reform legislation.
In the US House of Representatives (House), financial reform legislation was debated and considered during the latter half of 2009, culminating in December with the passage by the House of H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009 (original House-passed bill). Meanwhile, the US Senate (Senate) followed a slower track in its consideration of legislation in 2009 and 2010. On May 20, 2010, the Senate passed the Restoring American Financial Stability Act of 2010 (original Senate-passed bill), its counterpart to the House legislation, as a substitute amendment to H.R. 4173, and House and Senate leadership thereafter appointed a Conference Committee to reconcile the differences in the House and Senate bills. After extensive discussions amongst members of the Conference Committee, the Conference Committee reported out a Conference Report on H.R. 4173, the Dodd-Frank Wall Street Reform and Consumer Protection Act, that was sent to both houses of Congress for consideration.

The House approved the Conference Report legislation on June 30, after the Conference Committee reconvened to address the concerns of certain Senators with respect to the budgetary/tax impact of the legislation. The Senate subsequently approved the Conference Report on July 15. On July 21, President Obama signed the Dodd-Frank Act into law. As a result, many of the Dodd-Frank provisions become effective the next day (July 22), and the numerous implementation timelines that are tied to the date of enactment now begin to run.

C. Overview of the Legislation

The Dodd-Frank Act is massive and far-reaching financial reform legislation that will have a major and lasting impact on the financial condition and operations of US banks, non-bank financial institutions, and non-US banking organizations and other financial services organizations doing business in the United States. Major elements of the Dodd-Frank Act are as follows:

1. Framework for Financial Stability

The Dodd-Frank Act creates a new framework intended to promote the financial stability of the US financial services system. Title I of the Dodd-Frank Act creates a Financial Stability Oversight Council (FSOC), an inter-agency body that is responsible for monitoring the activities of the financial system and recommending a framework for substantially increased regulation of significant financial services firms, including large, interconnected BHCs, and systematically important nonbank financial companies that the FSOC determines pose a risk to financial stability. In addition, Title I establishes an Office of Financial Research (OFR) to support the FSOC by collecting information and conducting research. Title I further requires the Federal Reserve Board (FRB) to implement more stringent prudential standards, including capital requirements and resolution plans, and establishes a new supervisory framework for the regulation of large interconnected BHCs and systematically important nonbank financial companies.
Title VIII of the Dodd-Frank Act supplements Title I by providing for the oversight and regulation of designated financial market utilities (FMUs) and systemically important payment, clearance, and settlement activities.

2. **Orderly Liquidation Regimen**

Title II of the Dodd-Frank Act creates a liquidation framework for the resolution of certain BHCs, companies predominantly engaged in financial activities, and systemically significant nonbank financial companies that parallels in many respects the resolution authority currently exercised by the Federal Deposit Insurance Corporation (FDIC) for insured depository institutions. This authority, which may only be used by the Secretary of the Treasury (Secretary) in consultation with the President, based on the recommendations of the FRB and the FDIC, contemplates the resolution of important financial firms to mitigate serious adverse effects on financial stability in the United States. Under the orderly liquidation regime, the FDIC will be appointed the receiver of the designated company (unless the company is a broker or dealer, or an insurance company) and will liquidate the company in a manner that mitigates risk of financial instability and minimizes “moral hazard,” namely, the perception that the federal government will guarantee the obligations of the failing company. The orderly liquidation regime contemplates that the FDIC will exercise its authority to take control of failing firms in a manner that protects counterparties, minimizes market disruptions, and assures that losses of failed financial institutions are incurred first by shareholders and unsecured creditors. The cost of the orderly liquidation regimen, to the extent not recovered by the government through the sale of the failed firm’s assets, will be paid through assessments on large BHCs and systematically significant nonbank financial firms.

3. **Other Changes to the Bank Regulatory Structure**

Titles III and VI of the Dodd-Frank Act makes important changes to the structure of bank regulation, and expands bank regulatory powers in a variety of areas. Title III abolishes the OTS and transfers its functions and responsibilities to the Office of the Comptroller of the Currency (OCC) which assumes the supervision of federal savings and loan associations (thrifts), while the FDIC assumes the responsibility for supervising state-chartered thrifts. By the same token, the FRB assumes responsibility for supervising thrift holding companies. In addition, Title III revises the FDIC’s assessment base for deposit insurance by shifting from an assessment base defined by deposit liabilities to one based on total assets. In addition, Title III makes permanent the increase in federal deposit insurance to $250,000, retroactive to January 1, 2008, and extends full insurance coverage for noninterest-bearing transaction accounts through 2012.
Title VI separately augments in a number of respects the existing bank regulatory and supervisory structure. Title VI contains the controversial “Volcker Rule” which prohibits proprietary trading and private fund management activities, subject to narrow exemptions, and requires systemically important nonbank financial firms to hold additional capital and comply with additional quantitative requirements with respect to those activities. Title VI of the Dodd-Frank Act also contains provisions that impose a moratorium on federal deposit insurance approvals for certain “nonbank banks” and strengthen regulatory requirements pertaining to affiliate transactions, lending and concentration limits, charter conversions and other supervisory and regulatory matters. It also permits depository institutions to pay interest on commercial checking accounts, and expands the de novo interstate branching authority of domestic and non-US banks alike.

4. Increasing Consumer Protection

A key element of the Dodd-Frank Act is that it establishes a new federal regulatory structure for consumer protection. Title X of the Dodd-Frank Act creates the Bureau of Consumer Financial Protection (BCFP) as an independent bureau within the FRB and grants to the BCFP sweeping powers to administer and enforce a new federal regulatory scheme of consumer financial regulation. The BCFP has been given the authority to examine large providers of consumer financial services, including BHCs, depository institution subsidiaries and state licensed mortgage lenders, brokers and servicers. In addition, the Dodd-Frank Act limits the authority of the OCC to preempt the applicability of state consumer protection laws to national banks and federal thrifts, and gives the states the right not only to enforce their own state consumer protection laws against such banks and thrifts, but also to enforce the rules and regulations of the BCFP. The establishment of a financial consumer protection agency, a cornerstone of the Obama Administration plan, is intended to address perceived failings on the part of bank regulators to protect the interests of retail borrowers in mortgage and other consumer credit transactions in the years leading up to the financial crisis.

Title XIV of the Dodd-Frank Act provides for the regulation of residential mortgage lending activities in the United States in a manner that is designed to remedy many of the abuses in the subprime mortgage lending market that helped cause the financial crisis; however, the changes are not limited to subprime or adjustable rate mortgage loans. Among other things, these residential mortgage protection provisions require lenders to assess borrowers’ ability to repay their mortgages, and prohibit a variety of mortgage lending practices such as the “steering” of borrowers by mortgage originators into certain types of mortgage transactions and certain mortgage originator compensation arrangements, such as “yield spread premiums” (YSPs).
5. Derivatives Regulation

In response to the broad perception that the activities and risks of under-regulated over-the-counter (OTC) derivatives markets were a major contributing factor to the severity of the financial crisis, Title VII of the Dodd-Frank Act creates a new framework for the regulation of OTC derivatives activities. Title VII requires the centralized clearing of OTC derivatives, under which any OTC derivative that is accepted for clearing by a clearing organization generally must be cleared by that organization. In addition, Title VII creates a new regulatory scheme for the oversight and supervision of swap dealers and major swap participants, and provides new regulatory authority to the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC). The controversial proposal to require depository institutions to “push out” their swap activities was modified in the final hours of the conference to exempt hedging activities and traditional OTC swaps including interest rate and currency swaps.

6. Capital Markets and Investor Protection

Title IX of the Dodd-Frank Act broadly strengthens the regulatory oversight of securities and capital markets activities by the SEC, and creates new protections for investors in the form of increased private rights of action, the broadened ability of the SEC to bring aiding-and-abetting claims against violators of the federal securities laws, and directing the SEC to study and perhaps create a federal fiduciary duty for broker-dealers, akin to that for investment advisers, to protect retail customers. Title IX also gives broader powers to the SEC to regulate nationally recognized statistical rating organizations (NRSROs) by creating a new Office of Credit Ratings within the SEC, and gives the SEC the power to adopt regulations governing the organization and activities of NRSROs, including director independence, disclosures to the public and investors, internal controls, and controls over NRSRO conflicts of interest. In addition, the authority of regulated banks to rely on credit ratings in their lending and investment capital markets activities will be curtailed through changes in applicable banking laws.

Title IX also seeks to enhance the safety and soundness of the securitization process. Title IX broadly requires securitizers and originators to keep “skin in the game” by retaining an economic interest in a material portion of the credit risk for any asset that they securitize or originate. New risk retention requirements and exemptions will be determined by relevant regulatory authorities. In addition, Title IX strengthens existing laws and regulations governing corporate accountability, gives shareholders a “say on pay” and other corporate governance rights, and imposes limitations and remedies on perceived undesirable executive compensation practices.
7. Registration of Advisers to Hedge Funds, Private Equity Funds, and Others

Title IV of the Dodd-Frank Act requires advisers to hedge funds, private equity funds, and certain other types of private investment vehicles to register with the SEC. These advisers are, among other things, required to provide information to the SEC and other federal regulators.

8. Insurance Oversight and Regulatory Reform

Title V of the Dodd-Frank Act creates the Federal Insurance Office (FIO) within the Treasury, which will collect information, monitor the insurance industry, and make recommendations on modernizing and improving US insurance regulation. In addition, Title V confers limited authority on the FIO to preempt state laws that interfere with certain international insurance agreements and streamlines and rationalizes in certain respects the state regulation and taxation of non-admitted (surplus lines) insurance, and reinsurance.

9. Federal Reserve System Changes

In an effort to reform the operations of Federal Reserve System (the FRB and the Federal Reserve Banks) credit facilities and Federal Reserve System governance matters, Title XI of the Dodd-Frank Act imposes new limitations on the ability of the Federal Reserve System to make emergency loans under the general Federal Reserve Act (FRA) authority to provide such financial assistance. Title XI also limits the FDIC’s ability to establish liquidity programs to guarantee the short term debt obligations of financial institutions in times of financial distress. Further, the Government Accountability Office (GAO) is given authority to audit the activities of Federal Reserve System emergency credit facilities, as well as credit facilities that were created during the recent financial crisis. Title XI also makes changes to Federal Reserve Bank and FRB governance matters, including changes in the manner in which Federal Reserve Bank directors are elected, and establishes a Vice Chairman position at the FRB Governor level with authority over bank supervisory and regulatory matters.

10. Other Provisions

Title XII of the Dodd-Frank Act contains provisions that are designed to expand access to banking services and credit for low-income, minority, and other underserved families. As part of the last-minute steps to fund the costs of the legislation, Title XIII of the Dodd-Frank Act effectively terminates the TARP by requiring remaining TARP funds to be used for deficit reduction purposes, and enables the federal government better to recapture funds obligated or expended
under TARP, as well as under the American Recovery and Reinvestment Act of 2009 (ARRA).

As in the case with all legislative efforts of this magnitude, the Dodd-Frank Act contains requirements for numerous studies and reports by various federal government regulatory bodies, which will be completed over the next several months and years. Certain of these studies (e.g., a Volcker Rule study by FSOC) will serve as the basis for new implementing regulations.

D. Effective Dates and Implementation

Although the Dodd-Frank Act generally became effective one day after its enactment, many provisions of the legislation have extended implementation periods and delayed effective dates, and will be required to be implemented through regulatory action of the federal regulatory authorities. Because so many of the provisions of the Dodd-Frank Act require regulatory action for their implementation, in many respects the ultimate impact of the legislation, and its effects on the US financial markets and their participants, will not be fully known for an extended period of time. There is no question, however, that implementation of the many provisions of the legislation will impose enormous demands on the supervisory and legal resources of the implementing federal agencies, and significant new regulatory risk and compliance burdens and costs on the financial services industry and its participants.
TITLE I – FINANCIAL STABILITY

A. Summary

Title I of the Dodd-Frank Act addresses the issue of financial stability and systemic risk by: (i) establishing the FSOC to broadly oversee the financial services industry, monitor for systemic risk, and promote market discipline and (ii) requiring the designation and heightened regulation of systemically significant BHCs and nonbank financial companies. Title I grants new powers to the FRB to implement prudential standards for “large, interconnected bank holding companies” with $50 billion or more in consolidated assets (Systemic BHCs) and “nonbank financial companies supervised by the Board of Governors” (Systemic Nonbanks), including non-US companies. These prudential standards include capital, liquidity, short term debt limits, and credit exposure requirements, as well as resolution plans and stress testing. The FSOC and the FRB also have broad powers to request information from companies to determine if they are systemically significant, and the OFR is established to collect, analyze, and share information. The intent is that large, interconnected firms, whether they are banks, insurance companies, investment banks, or other financial intermediaries, will be subject to a stringent regulatory framework that will mitigate the risk that their activities or failure would threaten the stability of the US financial system.

Title I also contains the “Collins Amendment” which imposes minimum capital requirements on insured depository institutions and their holding companies, as well as Systemic Nonbanks. The intent was to eliminate, or at least greatly reduce, the use of hybrid capital instruments, such as trust preferred securities, to comply with regulatory capital requirements.

B. Establishment of the Financial Stability Oversight Council

1. Organization / Structure

   i. Composition

   The establishment of the FSOC is effective the date of enactment of the Dodd-Frank Act. It will consist of ten voting members and five non-voting members, with the Secretary designated to serve as a voting member and the Chairperson of the Council. The other voting members will be:
Understanding the New Financial Reform Legislation

- the Comptroller
- the Director of the BCFP
- the Director of the FHFA
- an independent member with insurance expertise who will serve a six-year term
- the Chair of the FRB
- the Chair of the FDIC
- the Chair of the SEC
- the Chair of the CFTC
- the Chair of the NCUA

The non-voting members of the FSOC will be:

- the Director of the OFR
- the Director of the FIO
- a state insurance commissioner, state banking supervisor, and a state securities commissioner, each of whom will serve a two year term

ii. Voting

The FSOC generally will meet at the request of the Chairperson, but must meet on at least a quarterly basis. While the FSOC’s ordinary voting business may be conducted based upon a majority vote, actions designating specific firms or activities for enhanced regulation or supervision generally will require a two-thirds vote, including the affirmative vote of the Chairperson.

2. Purpose and Duties of the FSOC

i. Purposes

The purposes of the FSOC are to identify risks to US financial stability, to promote market discipline, and to respond to emerging threats to the US financial system.

ii. Duties

Its broad duties include, among other things, monitoring risk and domestic and international regulatory proposals, facilitating information-sharing among regulatory agencies, designating nonbank financial companies as systemically significant, and providing recommendations to the FRB on prudential standards.
iii. **Information Collection**

The FSOC will have broad powers to collect information, including collecting information from nonbank financial companies to determine if they should be subject to prudential supervision. It may require reports from Systemic BHCs or Systemic Nonbanks concerning their financial condition and the extent to which their activities could, under adverse circumstances, have the potential to disrupt financial markets or affect US financial stability, subject to relying, to the extent possible, on existing reports and other available information.

iv. **Confidentiality and Protection of Privilege**

All information and reports submitted to the FSOC (including the OFR) will be kept confidential, and the submission of such information would not constitute a waiver of, or otherwise affect, any applicable privilege.

3. **Office of Financial Research**

i. **Duties**

Subtitle B establishes the OFR as the information-gathering and analysis arm of the FSOC with the following principal tasks:

- collecting data on behalf of the FSOC, and providing that data to the FSOC and member agencies
- standardizing the types and formats of data reported and collected
- performing research
- developing tools for risk measurement and monitoring
- making the results of the activities of the OFR available to financial regulatory agencies
- assisting the agencies in determining the types and formats of data authorized by the Dodd-Frank Act to be collected by those agencies

ii. **Structure**

The OFR consists of the “Data Center” (responsible for data collection) and the “Research and Analysis Center” (responsible for analyzing data to monitor for systemic risk), and is broadly empowered to require the submission of reports and information, including by way of subpoena authority granted to the OFR in Section 153(f).
iii. Funding

The OFR will be funded for its first two years by the FRB and, thereafter, through assessments to be paid by Systemic BHCs and Systemic Nonbanks.

C. Registration of Nonbank Financial Companies with the FRB and Identification of Systemic BHCs

1. US Nonbank Financial Companies

i. Designation

The FSOC may subject a “US nonbank financial company” to FRB supervision and to “prudential standards” if the FSOC determines by a two-thirds vote, including an affirmative vote by the Chairperson, that “material financial distress” at the nonbank financial company, or the “nature, scope, size, scale, concentration, interconnectedness, or mix of the activities” could pose a threat to US financial stability. Section 113(a)(2) lists factors that the FSOC must consider in making this determination, including the leverage, size and interconnectedness of the company, as well as the importance of the company as a source of credit for households, businesses, and state and local governments, and as a source of liquidity for the US financial system as a whole.

The FRB is required to issue regulations, in consultation with the FSOC, establishing criteria for exempting “certain types of classes” of nonbank financial company from supervision by the FRB.

ii. Predominantly Engaged

In order to be a “US nonbank financial company” susceptible to being made subject to FRB supervision, a company must be:

- organized under the laws of the United States or any state
- not a BHC or a subsidiary of a BHC
- “predominantly engaged” in financial activities

A nonbank company is predominantly engaged in financial activities if 85 percent or more of the consolidated annual gross revenues or consolidated assets of the company are attributable to (i) activities that are “financial in nature” (as defined in Section 4(k) of the BHCA), and (ii) if
applicable, from ownership of an insured depository institution. Activities that are “financial in nature” include (i) all kinds of lending and other forms of financing; (ii) underwriting, dealing in and brokering securities; (iii) derivatives activities; (iv) investment management; and (v) insurance activities. As a result, the Dodd-Frank Act could result in, for example, large insurance companies (even if they have no bank or thrift subsidiary) becoming subject to FRB supervision. However, inclusion of the “predominantly engaged” standard should ensure that commercial firms with only limited financial activities will not be subject to FRB supervision simply as a result of their size, interconnectedness, or overall importance to the US economy.

iii. **Appeal of Determination**

A US nonbank financial company that has been notified of a proposed determination by the FSOC to designate the company as a Systemic Nonbank will have 30 days to request a hearing before the FSOC to contest the designation. Any final determination made by the FSOC will be subject to judicial review either in the US District Court for the District of Columbia or the US district court in the district where the home office of the nonbank company is located, but review will be limited to whether the FSOC determination was “arbitrary and capricious.” The use of this review standard effectively will make the FSOC’s determinations in this regard very difficult to overturn.

iv. **Registration**

Following a final determination that a US nonbank financial company shall be designated as a Systemic Nonbank, the company will have 180 days to register with the FRB.

v. **Intermediate Holding Company Structure**

Section 167(a) provides that the nonfinancial activities of a Systemic Nonbank will not be subject to the general prohibition on nonbanking activities of Section 4 of the BHCA. However, the FRB may require that financial activities be placed beneath an intermediate holding company fully subject to the BHCA.

- The FRB is required to develop regulations setting forth when a Systemic Nonbank will be required to place its financial activities below an intermediate holding company.
• This intermediate holding company would then be treated as the Systemic Nonbank, and the commercial activities of the top-tier entity would not be subject to FRB supervision.

• A Systemic Nonbank that directly or indirectly controls this type of intermediate holding company:
  
  ▪ must serve as a source of strength to the intermediate holding company;
  ▪ may be required to file periodic reports with the FRB;
  ▪ must comply with FRB regulations applying affiliate transaction limitations to transactions between the parent (or its nonfinancial subsidiaries), and the intermediate holding company; and
  ▪ may be subject to FRB enforcement action as discussed below.

• This intermediate holding company regime largely mirrors the structure established under Section 626 to separate the commercial and financial activities of grandfathered unitary thrift holding companies.

2. Foreign Nonbank Financial Companies

i. Designation

The FSOC may subject a “foreign nonbank financial company” to FRB supervision if the FSOC determines by a two-thirds vote, including an affirmative vote by the Chairperson, that “material financial distress” at the foreign nonbank financial company, or the “nature, scope, size, scale, concentration, interconnectedness, or mix of the activities” of the company could pose a threat to US financial stability, taking into account the US presence of the company.

• In making the determination to subject a foreign nonbank financial company to FRB supervision, Section 113(b)(2) of the Dodd-Frank Act requires the FSOC to consider factors similar to those to be considered in designating a US nonbank financial company.

• The considerations must include, for example:
  
  ▪ the leverage of the company
  ▪ the amount and nature of the US financial assets of the company
  ▪ the amount and type of liabilities used to fund US operations
  ▪ the extent of US-related off-balance-sheet exposure
  ▪ the interconnectedness of the company
ii. Predominantly Engaged

In order to be a “foreign nonbank financial company” under the Dodd-Frank Act, a company must be:

- organized under the laws of a country other than the United States;
- not a BHC or a subsidiary of a BHC; and
- “predominantly engaged” in financial activities.

Non-US banks that are not BHCs because they do not own a US bank, but that are treated as BHCs under the IBA because they operate a US branch or agency, would also be considered to be BHCs. The term “predominantly engaged” is determined based upon the same 85 percent test described above applicable to US nonbank financial companies.

iii. Appeal

As with US nonbank financial companies, foreign nonbank financial companies will have the opportunity to request a hearing before the FSOC to contest a proposed designation, and would be permitted to submit a determination for judicial review under the arbitrary and capricious standard.

iv. Intermediate Holding Company Structure

As with US nonbank financial companies, the FRB can require foreign nonbank financial companies to establish an intermediate holding company structure.

- Such a company could be required to hold all of the foreign nonbank financial company’s financial activities in the United States.
- For the purposes of the FRB’s requirements concerning intermediate holding companies, it appears that under Section 102(c), only the US activities and subsidiaries of the foreign nonbank financial company would be affected.
v. Registration

Once a final determination has been made that a foreign nonbank financial company shall be designated as a Systemic Nonbank, the company will have 180 days to register with the FRB.

3. US Systemic BHCs

The Dodd-Frank Act applies its heightened prudential requirements to “large, interconnected bank holding companies.” The Dodd-Frank Act provides that any BHC with consolidated assets of $50 billion or more will be treated as a Systemic BHC. As discussed below, the FSOC and the FRB may establish a threshold above $50 billion for the application of certain heightened prudential standards.

4. Foreign Systemic BHCs

Non-US banks and non-US companies that either (i) are BHCs by virtue of their ownership of a US bank, or (ii) are treated as BHCs under the IBA because, for example, they operate a US branch or agency, will be treated as Systemic BHCs under the Dodd-Frank Act if they have at least $50 billion in consolidated assets. The Dodd-Frank Act does not limit this test to the US assets of non-US banks. As discussed above with respect to US BHCs, the FRB could raise the threshold with respect to certain standards.

5. Additional Considerations for Foreign Companies

Section 113(i) expressly requires that the FSOC consult with the appropriate non-US regulatory authorities in subjecting a foreign nonbank financial company or foreign BHC to regulation and supervision under Title I.

In making recommendations concerning applying prudential standards to foreign Systemic Nonbanks and foreign Systemic BHCs, the FSOC must give due regard to the principle of national treatment and equality of competitive opportunity, and also take into account the extent to which the foreign company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States.

Section 102(c) provides that references to “company” or “subsidiary” in Title I with respect to a foreign nonbank financial company will include only the US activities and subsidiaries of the company with the exception of the FSOC determination that such a company could pose a threat to US financial stability.
D. Prudential Standards to be Developed for Systemically Significant Institutions

In an effort to prevent or mitigate risks to US financial stability, the FSOC may recommend, and in any event the FRB is required to implement, “prudential standards” applicable to systemically significant institutions. These standards would:

- be more stringent than those applicable to entities not presenting similar risks
- increase in stringency based upon:
  - differences among entities
  - the goal of preventing small changes in requirements from having a disproportionate effect
  - an entity’s primary lines of business

Moreover, they are to vary in stringency based on various risk factors. Based on FSOC recommendation, the FRB may also establish an asset threshold above $50 billion for certain prudential standards relating to contingent capital requirements (if any), resolution plan and credit exposure reports, concentration limits, public disclosures, and short-term debt limits. The FSOC and the FRB thus appear to have considerable flexibility to tailor the prudential standards to the circumstances of different firms.

In applying the heightened prudential standards and other requirements of the Dodd-Frank Act to foreign Systemic BHCS and foreign Systemic Nonbanks, the FSOC and FRB must also give due regard to the principle of national treatment and equality of competitive opportunity, and consider home country supervision.

The FRB is required to establish prudential standards in the following areas:

- risk-based capital requirements and leverage limits
- liquidity requirements
- overall risk management
- resolution plan and credit exposure reporting
- concentration limits

In addition, the FRB may adopt prudential standards in the following areas:

- contingent capital
- enhanced public disclosures
- short-term debt limits
- other prudential standards deemed to be appropriate
The FRB is generally required to issue final regulations to implement Subtitles A and C of Title I within 18 months of the effective date of the Dodd-Frank Act, unless otherwise specified.

Each of these required and discretionary prudential standards is discussed below.

1. **Risk-Based Capital and Leverage Limits**

There are four provisions applicable to capital requirements in Title I:

- **Section 171** (commonly referred to as the Collins Amendment because it was sponsored by Senator Susan Collins (R-ME)), which will require the regulatory agencies to establish minimum capital requirements that mirror the requirements that currently apply to insured banks, for all insured depository institutions and their holding companies.
- **Section 165(b)(1)(A)(i)**, which will require the FRB to adopt risk-based capital and leverage limits for systemically significant companies higher than those applicable to non-systemic institutions.
- **Section 165(j)**, which requires the FRB to impose a 15:1 leverage ratio on a systemically significant company that poses a grave threat to the US financial system.
- **Section 115(c)** requires that the FSOC conduct a study of the feasibility of establishing a contingent capital requirement for Systemic Nonbanks and Systemic BHCs.

i. **Collins Amendment**

a. **New Standards for all Depository Institution Holding Companies and Systemic Nonbanks**

The Collins Amendment requires several changes to the current regulatory capital regime applicable to all BHCs and thrift holding companies and would apply as well to Systemic Nonbanks. The intent behind the Collins Amendment was to eliminate, or at least greatly reduce, the use of hybrid capital instruments, such as trust preferred securities, to comply with regulatory capital requirements.

- **Section 171** requires that the appropriate federal banking agencies establish minimum leverage and risk-based capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies, and Systemic Nonbanks.
As a result, insured depository institutions, but more significantly, their holding companies will be subject to the same capital requirements, and must include the same components in regulatory capital.

- Subjecting insured depository institutions and their holding companies to identical requirements represents a departure from prior practice and a tightening of holding company requirements. This provision was sought by the FDIC, in part, because it felt that assistance provided to insured depository institution subsidiaries was used to strengthen their holding companies, which during the height of the crisis were unable to act as a source of strength.

- The current leverage and risk-based capital requirements applicable to insured depository institutions under the FDIA’s “prompt corrective action” regime would serve as a floor on the minimum requirements that could be adopted under Section 171.

- The federal banking agencies also would be required to develop special capital requirements to address the risks of the activities conducted by these entities, taking into consideration volume of activity, asset concentration, and market share.

- The Collins Amendment would not apply to organizations that do not have bank or thrift subsidiaries and are not otherwise systemically significant nonbanks. Therefore, for example, it will not apply to most firms that only have industrial loan company or credit card bank subsidiaries.

b. Impact on Cumulative Preferred Stock and Other Forms of Hybrid Capital

- Holding companies with less than $15 billion in assets will continue to be able to include existing cumulative preferred stock (such as trust-preferred securities) in Tier 1 capital.

- Holding companies with $15 billion or more in assets must phase out their inclusion of cumulative preferred stock (including trust-preferred securities) in Tier 1 capital over a certain period (discussed below).

- Debt or equity instruments issued by the US government pursuant to EESA and before October 4, 2008 (i.e. TARP...
Preferred Securities) would not be impacted by the Collins Amendment.

- The GAO is required to conduct a study on the use of hybrid capital instruments, such as trust preferred securities, as a component of Tier 1 capital and must report the results to Congress within 18 months of enactment.

c. **Treatment of Small Bank Holding Companies**

- This section would not apply to “small bank holding companies” as defined in current FRB policies.

d. **Treatment of Non-US Banks and their Intermediate US Holding Companies**

- Any depository institution holding company organized in the United States that is owned or controlled by a “foreign organization” is covered by the requirements of Section 171, but the foreign organization is not.

  - In practice, this provision will undermine the ability of intermediate holding companies of non-US FHCs to rely on the guidance set forth in the FRB’s SR-01-1, which provides that, based upon an evaluation of the overall capital sufficiency of an organization, an intermediate US BHC owned and controlled by a non-US FHC determined by the FRB to be well-capitalized and well-managed was not required to comply with the FRB's general capital adequacy guidelines.

e. **Effective Date and Phase-In**

- For debt or equity instruments issued on or after May 19, 2010, by depository institution holding companies or by Systemic Nonbanks, this section shall be deemed to have become effective as of May 19, 2010.

- For debt or equity instruments issued before May 19, 2010, by depository institution holding companies with $15 billion or more in assets or Systemic Nonbanks, any regulatory capital deductions required under this section are phased in incrementally over a period of three years, with the phase-in period to begin on January 1, 2013.
For debt or equity instruments issued before May 19, 2010, by depository institution holding companies with total consolidated assets of less than $15 billion as of December 31, 2009, and by organizations that were mutual holding companies on May 19, 2010, the capital deductions that would be required for other institutions under this section are not required.

For any depository institution holding company that was not supervised by the FRB as of May 19, 2010, the general requirements of this section shall be effective five years after the date of enactment.

- For these organizations, however, the treatment of instruments issued on or after May 19, 2010, will be the same as described above.

For intermediate BHC subsidiaries of non-US banking organizations that have relied on SR-01-1 (as in effect on May 19, 2010), the requirements of this section shall be effective five years after the date of enactment.

- For such BHC subsidiaries, however, instruments issued on or after May 19, 2010, will be subject to these requirements as of May 19, 2010.

**f. Study of Foreign Bank Intermediate Holding Company Capital Requirements**

Section 174(b) requires the GAO, in consultation with Treasury, the FRB, the OCC, and the FDIC, to conduct a study of capital requirements applicable to US intermediate holding companies of non-US banks that are BHCs or thrift holding companies. A report on the results of the study must be provided to Congress within 18 months of enactment. The study must consider:

- current FRB policy regarding the treatment of intermediate holding companies;
- the principles of national treatment and equality of competitive opportunity;
- the extent to which non-US banks are subject on a consolidated basis to home country capital standards comparable to US standards;
• potential effects on US banking organizations operating abroad of changes to US policy regarding intermediate holding companies;
• the impact on the cost and availability of credit in the United States from a change in US policy regarding intermediate holding companies; and
• any other relevant factors relating to the safety and soundness of the US financial system and potential economic impact of such a prohibition.

ii. Heightened Requirements for Systemic Entities

• Section 165 requires the FRB to establish risk-based capital and leverage limits applicable to Systemic BHCs and Systemic Nonbanks, and the FSOC may recommend such standards. The FRB in consultation with the FSOC may determine that heightened capital requirements may not be appropriate for a company engaged in activities like asset management, in which case other standards should be developed to result in strict risk controls.
• The capital computation must take into account any off-balance-sheet activities of the company.

iii. Fixed Leverage Limit for Certain Companies

Section 165(j) provides that the FRB shall require a Systemic BHC or Systemic Nonbank to maintain a debt-to-equity ratio of no more than 15-1, following a determination by the FSOC that the company poses a “grave threat” to US financial stability and that the imposition of the limit is necessary to mitigate that risk.

iv. Contingent Capital Study

Following the financial crisis, common equity has taken on greater significance as compared to more debt-like capital instruments.

• Section 115(c) requires that the FSOC conduct a study of the feasibility, benefits, costs, and structure of a contingent capital requirement for Systemic Nonbanks and Systemic BHCs.
• The FSOC must submit a report to Congress regarding this study within two years of the date of enactment of the Dodd-Frank Act.
• Following the submission of the report to Congress, the FSOC may make recommendations to the FRB, and the FRB may issue regulations to require any Systemic Nonbank or Systemic BHC to
maintain a minimum amount of long-term hybrid debt that is convertible to equity in times of financial stress.

2. **Liquidity Requirements**

The FSOC may recommend, and the FRB shall establish, liquidity requirements applicable to Systemic BHCs and Systemic Nonbanks in order to prevent or mitigate risks to US financial stability. These liquidity requirements are likely to build upon the general principles set out in the March 17, 2010, "Interagency Policy Statement on Funding and Liquidity Risk Management."

3. **Overall Risk Management/Risk Committees**

- The FRB shall require each publicly traded Systemic Nonbank to establish a risk committee, not later than one year after the date of receipt of final determination to treat the nonbank financial company as a Systemic Nonbank.
- The FRB shall issue regulations requiring each publicly traded BHC with total consolidated assets of $10 billion or more to establish a risk committee.
- The FRB may require each publicly traded BHC with total consolidated assets of less than $10 billion to establish a risk committee, as determined necessary or appropriate to promote sound risk management practices.

A risk committee shall:

- be responsible for the oversight of the enterprise-wide risk management practices of the company;
- include such number of independent directors as the FRB may determine appropriate, based on the nature of its operations, size of assets, and other appropriate criteria related to the company; and
- include at least one risk management expert having experience in identifying, assessing, and managing risk exposures of large, complex firms.

The FRB must issue final rules to carry out this subsection not later than one year after the “transfer date” to take effect not later than 15 months after the transfer date.

- The “transfer date,” as defined in Section 311, means the date that is one year after the date of enactment of the Dodd-Frank Act, although it may be extended to not later than 18 months after the date of enactment.
4. **Resolution Plans**

Taking into account any recommendations from the FSOC, the FRB must require that each Systemic Nonbank and Systemic BHC periodically submit to the FRB, the FSOC, and the FDIC a plan for the rapid and orderly resolution of the company in the event of material financial distress or failure. These plans have come to be known as “living wills.”

- The plan must address (i) how the insured depository institution is protected from risk arising from activities of nonbank affiliates, (ii) a full description of the company’s assets, liabilities and contractual obligations, and (iii) identification of cross-guarantees tied to different securities, major counterparties, and a process to determine to whom collateral is pledged.
- If the FRB and the FDIC jointly determine that the resolution plan is not credible, or would not facilitate an orderly resolution of the company, the FRB and FDIC will notify the company of the deficiencies and provide the company an opportunity to submit a revised plan and to demonstrate the plan is credible.
- If a Systemic Nonbank or Systemic BHC fails to resubmit its revised resolution plan in a timely manner, the FRB and FDIC are authorized to jointly impose more stringent capital, leverage, or liquidity requirements, or restrictions on the growth, activities, or operations of the company, or any subsidiary, until the company resubmits a plan that remedies the deficiencies.
- Once the FRB and FDIC impose these more stringent requirements, if a Systemic Nonbank or Systemic BHC fails to submit its revised resolution plan within the two-year period beginning on the date the requirements were imposed, the FRB and FDIC, in consultation with the FSOC, may order that the Systemic Nonbank or Systemic BHC divest certain assets or operations in order to facilitate an orderly resolution of the company.
- The plan would not be binding on a bankruptcy court or a receiver under Title II of the legislation, and would not form the basis for a private right of action.
- As with all information and reports submitted under Title I, resolution plans will be maintained as confidential, and the submission of such information would not constitute a waiver of, or otherwise affect, any applicable privilege.

i. **Timing for Implementation**

The FRB and FDIC will have 18 months from the date of enactment of the Dodd-Frank Act to jointly issue final rules implementing this section.
ii. May 2010 FDIC Rule Proposal

Highlighting the importance both of coordinated action among US regulators, and the extensive global coordination that will be required under the Dodd-Frank Act, the FDIC recently issued a proposed rule that would require certain “identified insured depository institutions” that are subsidiaries of large and complex financial parent companies to submit analysis, information, and contingent resolution plans to the FDIC.

5. Concentration Limits, Credit Exposure and Application of Attribution Rule

Section 165(e) requires the FRB to issue regulations that prohibit each Systemic Nonbank and Systemic BHC from having “credit exposure” to any unaffiliated company that exceeds 25 percent of its capital stock and surplus, although the FRB may set a lower limit by regulation.

- “Credit exposure” is broadly defined to include all extensions of credit, credit exposure under repurchase agreements and securities lending arrangements, guarantees and other credit enhancements, investments in a company’s securities, and credit exposure arising from derivatives transactions.
- Compliance with the rule will be complicated by the “attribution rule” contained in Section 165(e)(4).
  - Under this attribution rule, any transaction by a Systemic Nonbank or Systemic BHC with any person is a transaction with a company, to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that company.
  - The attribution rule thus imposes a significant monitoring and tracking burden on a systemically significant institution, as every transaction could have downstream implications for its credit exposure limitation.

- The FRB must require each Systemic Nonbank and Systemic BHC to prepare and provide to the FRB and the FDIC a Credit Exposure Report identifying significant exposures of the company to other major counterparties and significant exposures of other counterparties to the reporting company.
- The FRB may issue regulations implementing these requirements, including exempting transactions from the definition of credit exposure if the FRB concludes that the exemption is in the public interest.
These regulations are likely to be informed by existing guidance on concentration and counterparty credit risk, such as the April 30, 2010, "Interagency Guidance on Correspondent Concentration Risk."

- The effective date will be three years after the date of enactment, and the FRB may extend the period for an additional two years.

6. **Enhanced Public Disclosures**

Under Section 165(f), the FRB may require, by regulation, periodic public disclosures by Systemic Nonbanks and Systemic BHCs in order to support the market’s evaluation of the risk profile, capital adequacy, and risk management capabilities of those entities.

7. **Short-Term Debt Limits**

The FRB may, by regulation, limit the amount of short-term debt, including off-balance sheet exposures, that may be accumulated by any Systemic Nonbank or Systemic BHC.

- Any limit must be based on the short term debt of the company as a percentage of capital stock and surplus, or on another measure the FRB considers appropriate.
- “Short-term debt” means those liabilities with a short-dated maturity (excluding insured deposits) that the FRB identifies by regulation.

E. **Other Requirements Intended to Protect the Financial System**

1. **Heightened Requirements Applicable to Activities**

The FSOC may recommend that the primary financial regulatory agencies apply new or heightened standards and safeguards to any activity or practice that the FSOC determines could create or increase the risk of significant liquidity, credit, or other problems spreading within the financial system. These recommended actions could apply, not just to systemically significant companies, but to all bank holding companies.

2. **Mitigation of a Grave Threat to Financial Stability**

Under Section 121, if the FRB determines that a Systemic Nonbank or Systemic BHC poses a “grave threat” to US financial stability, the FRB shall, upon an affirmative vote of not fewer than two-thirds of the FSOC members then serving:
• require the company to terminate one or more activities, impose conditions on the manner in which the company conducts activities and restrict the offer of financial products;
• limit mergers and acquisitions by the company; or
• if the FRB determines that such actions are inadequate to mitigate a threat to US financial stability in its recommendation, to sell or otherwise transfer assets or off-balance-sheet items to unaffiliated entities.

In addition, as noted above, under Section 165(j) a Systemic BHC or Systemic Nonbank can be required to maintain a debt-to-equity ratio of no more than 15-1, following a determination by the FSOC that the company poses a “grave threat” to US financial stability, and that the imposition of the limit is necessary to mitigate that risk.

The FRB is empowered, but not required, to prescribe regulations as to how Section 121 would be applied to a foreign Systemic Nonbank or foreign Systemic BHC, taking into account national treatment, equality of competitive opportunity, and the extent to which the foreign company is subject to home country regulation comparable to that applicable to US financial companies.

3. Stress Testing

The FRB will be required to conduct annual stress testing of Systemic Nonbanks and Systemic BHCs, in coordination with the appropriate primary federal regulatory agency, if any.

• The tests will consider “baseline,” “adverse,” and “severely adverse” scenarios.
• Resolution plans may have to be updated based upon the results of stress testing.
• The FRB will publish a summary of the results of the testing.

In addition:

• Systemic Nonbanks and Systemic BHCs will be required to conduct internal stress tests on a semi-annual basis, and
• All other financial companies supervised by a primary federal regulatory agency and having assets over $10 billion must conduct internal stress tests annually.
4. Limitations on Acquisitions

Systemic Nonbanks will be treated as BHCs for purposes of Section 3 of the BHCA.

- As a result, no Systemic Nonbank may acquire or otherwise control five percent or more of any class of voting securities of a bank or BHC without prior notice to and approval from the FRB.

The Treasury Secretary is required to conduct a study of the impact of limits on the maximum size of banks and other financial institutions and other regulatory limitations intended to reduce systemic risk on (i) capital markets, (ii) the financial sector, and (iii) national economic growth. Treasury is required to report the findings of the study to Congress within 180 days of the date of enactment.

Both Systemic Nonbanks and Systemic BHCs will be subject to a requirement to provide prior written notice to the FRB before directly or indirectly acquiring any voting shares of any company with total consolidated assets of $10 billion or more that is engaged in activities that are financial in nature (as defined in Section 4(k) of the BHCA).

- This prior notice requirement would not apply to voting shares acquired under the exemptions in Sections 4(c) or 4(k)(4)(E) of the BHCA including the five percent exemption in Section 4(c)(6).

5. Early Remediation Requirements

The Dodd-Frank Act does not subject Systemic BHCs and Systemic Nonbanks to the FDIA’s PCA regime. However, the FRB is required to prescribe regulations, in consultation with the FSOC and FDIC, to impose PCA-like “early remediation requirements” that would apply to Systemic BHCs and Systemic Nonbanks in “financial distress.” Thus, the regulations to be prescribed by the FRB are required to:

- define measures of the financial condition of the company, including regulatory capital, liquidity measures, and other forward-looking indicators; and
- establish requirements that increase in stringency as the financial condition of the company declines, including:
  - requirements in the initial stages of financial decline, including limits on capital distributions, acquisitions, and asset growth; and
requirements at later stages of financial decline, including a capital restoration plan and capital-raising requirements, limits on transactions with affiliates, management changes, and asset sales.

6. **Depository Institutions Management Interlocks Act**

A Systemic Nonbank is treated as a bank holding company under the Depository Institutions Management Interlocks Act, except the FRB may not permit dual service by a management official of a Systemic Nonbank with a Systemic BHC or another Systemic Nonbank.

7. **Ceasing to be a BHC**

Section 117 of the Dodd-Frank Act limits the ability of a BHC to “de-bank” and thus avoid the requirements of the BHCA. This provision will apply to any entity that:

- was a BHC with consolidated assets of $50 billion or more as of January 1, 2010, and
- received financial assistance under or participated in the TARP Capital Purchase Program.

If such an entity were to de-bank or otherwise cease to be a BHC at any time after January 1, 2010, then Section 117 requires that that entity be treated as a Systemic Nonbank.

- This treatment may be appealed in a hearing before the FSOC, but the Dodd-Frank Act does not appear to provide for any judicial review of a final determination.
- However, the FSOC must annually review and reevaluate any denial of an appeal under this section.

F. **Supervision and Reporting**

1. **FRB Supervision of Systemic Nonbanks**

The Dodd-Frank Act authorizes the FRB to impose reporting requirements on Systemic Nonbanks, examine Systemic Nonbanks, and exercise enforcement powers patterned after the FRB’s powers to supervise BHCs.

The FRB must use existing reports and financial information to the fullest extent possible, and must provide reasonable notice to, and consult with, the primary financial regulatory agency for any subsidiary before requiring a report.
• It must also, to the fullest extent possible, avoid duplication of examination activities by relying on reports of examination of any subsidiary depository institution or functionally regulated subsidiary made by the primary financial regulatory agency for that subsidiary, and on existing reports and financial information. In addition, the FRB must provide reasonable notice to, and consult with, the primary financial regulatory agency for any subsidiary before commencing an examination of such subsidiary.

• With respect to a depository institution subsidiary or functionally regulated subsidiary of a Systemic Nonbank, the FRB may recommend, in writing to the primary financial regulatory agency for the subsidiary, that the agency initiate a supervisory action or enforcement proceeding. Such a recommendation must be accompanied by a written explanation of the concerns involved.

i. Backup FRB Authority

The FRB may take the recommended supervisory or enforcement action itself, as if the subsidiary were a BHC, if the primary financial regulatory agency does not take supervisory or enforcement action against the subsidiary that is acceptable to the FRB within 60 days after receiving a recommendation from the FRB.

ii. Application to Foreign Systemic Nonbanks

These requirements would apply to the US activities and subsidiaries of foreign Systemic Nonbanks, subject to the requirement noted above that, in applying heightened prudential standards and other requirements of the Dodd-Frank Act to foreign Systemic Nonbanks, the FRB must give due regard to the principle of national treatment and equality of competitive opportunity, and consider home country supervision.

2. Expanded FDIC Supervisory Authority

Section 172 amends the FDIA to provide the FDIC expanded examination authority over Systemic Nonbanks and Systemic BHCs, as well as backup enforcement authority over depository institution holding companies and their affiliates.

i. Expanded Examination Authority over Systemic Entities

The authority of the FDIC to conduct special examinations under the FDIA is expanded to permit the FDIC to examine a Systemic Nonbank or Systemic BHC, whenever the FDIC Board of Directors determines that a
special examination is necessary for the purpose of implementing its authority to provide for orderly liquidation of a systemic entity.

- This authority may not be used with respect to a company that is in a generally sound condition.
- Before conducting this special examination, the FDIC must review the company’s resolution plan and available examination reports, and must coordinate “to the maximum extent practicable” with the FRB in order to minimize duplicative or conflicting exams.

ii. Expanded Backup Enforcement Authority over Depository Institution Holding Companies

The FDIC’s authority to take enforcement action is expanded to authorize the FDIC to:

- recommend that the appropriate federal banking agency take enforcement action against a depository institution holding company
- take the action itself if (i) the appropriate federal banking agency does not within 60 days of a recommendation, and (ii) the conduct or threatened conduct of the depository institution holding company poses a risk to the deposit insurance fund

G. Efforts to Encourage Development of Similar Restrictions and Requirements Outside of the United States

Section 173 amends the IBA and the Exchange Act in an effort to encourage other countries to impose similar standards to the Dodd-Frank Act, and to discourage regulatory arbitrage opportunities created by jurisdictions with differing standards.

1. US Offices of Foreign Banks

The IBA is amended to permit the FRB to consider whether the home country of a foreign bank that presents a risk to US financial stability has adopted, or is making “demonstrable progress” toward adopting, an “appropriate system of financial regulation” for the financial system of such home country to mitigate such risk, in considering:

- any application to establish a US office of a foreign bank that presents a risk to US financial stability; and
- whether to terminate a US office of such a foreign bank.
2. Broker-Dealer Registration

The Exchange Act is amended to permit the SEC to consider whether, for a foreign person, or an affiliate of a foreign person that presents a risk to the stability of the US financial system, the home country of the foreign person has adopted, or made demonstrable progress toward adopting, an appropriate system of financial regulation to mitigate such risk, in determining:

- whether to permit a foreign person or an affiliate of a foreign person to register as or succeed to the registration of a US broker or dealer; and
- whether to terminate the registration of such a foreign person or affiliate as a broker or dealer.
TITLE II – ORDERLY LIQUIDATION AUTHORITY

A. Summary

Title II of the Dodd-Frank Act creates a new mechanism for the orderly liquidation of certain BHCs, companies predominantly engaged in financial activities, and systemically significant nonbank financial companies. This new liquidation authority is intended to eliminate taxpayer bailouts of companies that are “too big to fail” by providing the FDIC with the tools necessary to conduct an orderly liquidation of systemically important nonbank financial companies. The requirement that all financial companies put into receivership under this Title must be liquidated, coupled with the new limitations on the FRB’s Section 13(3) authority to aid individual companies, are designed to prevent the government from continuing to financially support and operate ailing financial companies. This receivership authority granted as part of the orderly liquidation process is modeled largely on the FDIC’s resolution authority for insured depository institutions under the FDIA, although it has been tailored to suit nonbank financial companies by importing concepts from the US Bankruptcy Code. It is expected that the orderly liquidation authority set out in Title II will be used in very limited circumstances with the Bankruptcy Code remaining the primary mechanism for resolving nonbank financial companies.

B. Covered Financial Companies

The orderly liquidation authority would permit the FDIC to liquidate “covered financial companies.” Title II of the Dodd-Frank Act defines “financial company” as a company that is incorporated or organized under any provision of federal or state law and is a:

- BHC;
- nonbank financial company supervised by the FRB;
- company that is “predominantly engaged” in activities the FRB has determined to be financial in nature under Section 4(k) of the BHCA; or
- any subsidiary of the foregoing that is predominantly engaged in activities the FRB has determined to be financial in nature under Section 4(k) of the BHCA.

A company is “predominantly engaged” in activities the FRB has determined to be financial in nature under Section 4(k) of the BHCA if the consolidated revenues of the company from such activities constitute at least 85% of the total consolidated revenues of the company and its subsidiaries (including insured depository institutions), as the FDIC, in consultation with Treasury, establishes by regulation.
A “covered financial company” is a financial company subjected to the new regime based on the determinations described in Section D below.

C. Excluded Entities

The Dodd-Frank Act excludes the following entities from the definition of “financial company:”

- Farm Credit System institutions chartered under the Farm Credit Act;
- governmental entities;
- GSEs (Fannie Mae and Freddie Mac); and
- FHLBs.

The Dodd-Frank Act excluded GSEs, despite attempts by the House to include them within the definition of “financial company” and subject them to the orderly liquidation authority. The Dodd-Frank Act does not define “governmental entity.” The Dodd-Frank Act also excludes non-financial subsidiaries of financial companies, as well as insured depository institutions. While insurance companies may be a covered financial company, the liquidation or rehabilitation of such companies and any subsidiary or affiliate that is also an insurance company would be conducted in accordance with state law.

Because a covered financial company must be organized or incorporated under federal or state law, this would exclude non-US entities, such as non-US banks and insurance companies, from the coverage of Title II. However, their US subsidiaries (except insured depository institutions) could be covered financial companies under Title II.

D. Process for Determining That a Financial Company Is Subject to the New Orderly Liquidation Regime

Title II establishes a comprehensive process for determining whether the FDIC should be appointed as receiver and the financial company liquidated in accordance with the orderly liquidation process. This process generally requires the consent of the Treasury, FDIC, and the FRB, and an up-front review of this determination by a federal district court.

1. Written Recommendation to Appoint Receiver

On their own initiative or at the request of Treasury, the FRB and the FDIC shall consider whether to make a written recommendation with respect to whether Treasury should appoint the FDIC as receiver of a financial company. Two-thirds of the members of the FRB and two-thirds of the members of the FDIC’s Board of Directors must approve any such recommendation. In the case of a broker-dealer, or for financial companies where the broker-dealer is the largest US subsidiary,
the recommendation must be approved by two-thirds of the members of the FRB and two-thirds of the members of the SEC; for insurance companies, the recommendation must be approved by two-thirds of the members of the FRB and the Director of the FIO, in consultation with the FDIC.

2. **Systemic Risk Determination by Treasury**

Having received the written recommendation of the FRB and FDIC (or other required agency), Treasury may make a determination that the FDIC should be appointed as receiver for a financial company if, in consultation with the President, it finds that:

- the financial company is in default or in danger of default;
- the failure of the financial company and its resolution under the otherwise applicable law would have “serious adverse effects on financial stability in the United States;”
- there is no viable private sector alternative to prevent the financial company’s default;
- the impact of liquidation by the FDIC on creditors, counterparties, and shareholders of the financial company and other market participants would be appropriate given the impact of such liquidation on financial stability in the United States;
- the liquidation would avoid or mitigate adverse effects on financial stability; and
- a federal agency has ordered the financial company to convert all its convertible debt instruments to equity.

A financial company would be in default or in danger of default if:

- a bankruptcy case with respect to the financial company has been, or is soon likely to be, filed;
- the financial company has incurred, or is likely to incur, losses depleting all or substantially all of its capital, and there is no chance to avoid such capital depletion;
- the assets of the financial company are, or are likely to be, less than its liabilities; or
- the financial company is not able to pay its obligations in the normal course of business.

To the extent that the FDIC is appointed as receiver for a covered financial company, the provisions of Title II would govern all matters and no provisions of the US Bankruptcy Code would apply.
3. Judicial Review of Determination

If, upon notification of Treasury’s determination that the FDIC should be appointed receiver for a financial company, the board of directors of the company does not acquiesce to the appointment of the FDIC as receiver, Treasury must confidentially petition the US District Court for the District of Columbia for an order authorizing the appointment of the FDIC as receiver. Disclosure of the Treasury’s determination or the pendency of a court proceeding is punishable by a fine or imprisonment. The Dodd-Frank Act provides that the board of directors of a financial company are not liable for acquiescing or consenting in good faith to the appointment of the FDIC as receiver. This may provide some incentive for the board of directors to consent and eliminate the need for judicial review.

After notice to the covered financial company and opportunity for a hearing, the court, in a confidential proceeding, would review on an “arbitrary and capricious” standard Treasury’s determination that the covered financial company was (a) in default or in danger of default, and (b) is a “financial company” as defined under Title II of the Dodd-Frank Act. Importantly, the court would not have the right to review any other determinations made by Treasury, including whether the financial company’s failure would have a serious adverse effect on the financial stability of the United States.

If the court fails to make a determination within 24 hours of receipt of Treasury’s petition, the petition is automatically granted. The covered financial company may appeal the court’s determination to the US Court of Appeals for the DC Circuit, and to the US Supreme Court. An appeal of the court’s determination, however, would not operate as a stay or injunction on the appointment of the FDIC as receiver or the commencement of the orderly liquidation.

E. FDIC Appointment; Receivership Duties and Powers

Any appointment of the FDIC as receiver terminates in three years subject to two possible one year extensions if the FDIC certifies in writing to Congress the need for such an extension. Subject to certain limitations, this period can be extended for the purpose of completing ongoing litigation involving the FDIC as receiver. With respect to any orderly liquidation undertaken pursuant to Title II, the FDIC shall (i) determine that such action is necessary for the financial stability of the United States rather than for the purpose of preserving the covered financial company; (ii) ensure that the shareholders do not receive payment until all other claims are paid; (iii) ensure that unsecured creditors bear the losses in accordance with the priority of claims provisions; (iv) ensure that the management and the board of directors of the covered company have been removed; and (v) not take any equity interest or become a shareholder of the covered financial company.
1. **Subsidiaries of a Covered Financial Company**

If the FDIC is appointed as receiver of a covered financial company, it may appoint itself as receiver for any covered subsidiary that is organized under federal law or the laws of any state, if the FDIC and Treasury jointly determine that (i) the covered subsidiary is in default or danger of default, (ii) such action would avoid or mitigate serious adverse effects on the financial stability or economic condition of the United States, and (iii) such action would facilitate that orderly liquidation of the covered financial company. A covered financial subsidiary does not include an insured depository institution, an insurance company, or a covered broker or dealer.

2. **Orderly Liquidation Modeled on FDIA**

The powers of the FDIC under Title II of the Dodd-Frank Act are modeled on the resolution authority for insured depository institutions under the FDIA. These powers would permit the FDIC to:

- take over the assets of and operate the financial company, to sell assets or transfer assets to a bridge financial company, and to merge the covered financial company with another company;
- value and prioritize claims;
- avoid fraudulent transfers and preferences;
- seek injunctive relief against any asset anywhere (without the necessity of showing irreparable harm);
- prioritize administrative expenses of the receiver;
- repudiate contracts, including qualified financial contracts, and limit damages for such repudiation;
- transfer qualified financial contracts and give notification of transfer;
- impose a one business-day (effectively allowing a weekend to transfer) automatic stay of termination rights for qualified financial contracts (as opposed to the three days in the original Senate-passed bill);
- recognize security interests and customer interests;
- enforce contracts;
- invalidate *ipso facto* clauses;
- require consent for the termination, acceleration, or declaration of default under any contract to which the covered financial institution is a party;
- pursue directors and officers of a covered financial company for gross negligence or intentional tortuous conduct;
- require that all contracts be written ("*D’Oench Duhme*" doctrine);
- create and operate bridge financial companies; and
- prohibit settlements with secrecy agreements and protective orders.
3. **Differences from FDIA Provisions**

The powers and duties of the FDIC under Title II of the Dodd-Frank Act also contain key differences from, and additions to, the provisions in the FDIA. These provisions are modeled on the US Bankruptcy Code, in recognition of the broader nature of the businesses of financial companies and their non-banking affiliates. They include:

- legally enforceable or perfected security interests avoidable only if they are preferential or fraudulent transfers;
- set-off rights as under US Bankruptcy Code;
- maximum liability of FDIC to any person having a claim against the FDIC as receiver or the covered financial company is the amount that the claimant would have received of claims in default no more than if covered financial company had been liquidated under Chapter 7 of the US Bankruptcy Code; and
- continued ability to enforce contracts of subsidiaries or affiliates of the covered financial company that are guaranteed by the covered financial company if (a) the guaranty and all related assets and liabilities are transferred to and assumed by a bridge financial company or third party within the same period of time as the FDIC is entitled to transfer such financial company’s qualified financial contracts or (b) the FDIC as receiver provides adequate protection for such obligations.

While the maximum liability of the FDIC for claims is limited by the statute, determining the amount that a creditor would have received under a Chapter 7 liquidation will likely prove to be a difficult and potentially speculative task.

4. **Purposes of Orderly Liquidation**

The purpose of the orderly liquidation process is to ensure that (i) private sector (creditors and shareholder) bear the cost of the proceeding; (ii) management is removed; and (iii) the responsible parties are held accountable. This is different than the purpose underlying a US Bankruptcy Code proceeding and may ultimately produce a result that is less favorable for creditors and other interested parties.

F. **Orderly Liquidation of Covered Brokers and Dealers**

1. **FDIC Appointment of SIPC as Trustee**

Title II of the Dodd-Frank Act provides for resolution authority for covered broker-dealers (i.e., broker-dealers registered with the SEC and that are members
of SIPC). After the FDIC’s appointment as receiver for a covered broker-dealer, it is required to appoint SIPC to act as trustee for the broker-dealer’s liquidation. SIPC would apply its normal liquidation processes, and have the same rights, powers, and duties for a liquidation under Title II as it does under the SIPA. The rights and obligations of parties to a qualified financial contract are not governed by SIPC processes, but rather under Section 210 of the Dodd-Frank Act.

2. **FDIC Creation of Broker-Dealer Bridge Company**

The FDIC has the right to create a bridge financial company, transfer assets and liabilities, enforce or repudiate contracts, or take any other action with respect to such bridge company under Title II. This bridge company would be deemed registered with the SEC and SROs and could operate as a broker-dealer, in compliance with the securities laws. SIPC must continue to liquidate the covered broker-dealer in accordance with its normal processes, despite any actions taken by the FDIC in the creation of a bridge company.

G. **Orderly Liquidation of Insurance Companies**

For covered financial companies that are insurance companies (and affiliate or subsidiary insurance companies), the state insurance regulator is responsible for the liquidation or rehabilitation conducted pursuant to state laws. If the state insurance regulator has not filed the appropriate judicial action in state court to place the company in liquidation pursuant to state law within 60 days after the determination, the FDIC is authorized to stand in the place of the state insurance regulator and file the appropriate liquidation action in state court.

H. **Orderly Liquidation and Repayment Plans**

1. **Orderly Liquidation Fund**

Title II of the Dodd-Frank Act establishes an orderly liquidation fund within Treasury, to be managed by the FDIC. The Dodd-Frank Act does not provide for a pre-funded orderly liquidation fund, as was contained in the original Senate proposal released in March 2010 by SBC Chairman Christopher Dodd (D-CT) and the original House-passed bill. Opponents believed that a pre-funded resolution fund would encourage the use of the orderly liquidation process and potentially undermine the intended limited use of this Title. Under the Dodd-Frank Act, the FDIC is authorized to fund the costs of liquidating a covered financial company by borrowing from Treasury, up to a maximum amount of:
• 10 percent of the book value of the covered financial company’s total consolidated assets during the first 30 days after the appointment of the FDIC as receiver; and
• 90 percent of the fair value of the covered financial company’s total consolidated assets after the first 30 days.

2. Repayment Plan

Prior to borrowing, Treasury and the FDIC must execute an agreement, in consultation with Congress, that provides a specific plan and schedule to repay the debt. The plan must also show that income from the liquidated assets of the covered financial company, in combination with assessments, will be sufficient to amortize the outstanding amount, including interest, owed to Treasury within the time frame established in the repayment schedule. Treasury and the FDIC must submit a copy of the repayment schedule to Congress within 30 days of the receipt of funding by the FDIC.

3. Risk-Based Assessments to Recover Costs

If necessary to repay the debt to Treasury and the costs of any liquidation, the FDIC must impose risk-based assessments. First, any claimant that received more money in the FDIC’s resolution than such claimant would have received in a liquidation under the US Bankruptcy Code or in an SIPC proceeding, must refund the difference. The assessments shall next be imposed, if necessary, on BHCs with total consolidated assets of $50 billion or more, and nonbank financial companies regulated by the FRB. The Dodd-Frank Act contemplates that the assessments criteria will be risk-based, taking into account a financial company’s business.

i. Risk Matrix

The FDIC must impose graduated assessments based on a risk matrix developed by the FDIC in consultation with the FSOC. The FDIC and FSOC must take the following factors into account when developing the risk matrix:

• economic conditions generally at the time;
• assessments imposed on a financial company or any affiliate that is an insured depository institution, SIPC member, or insurance company;
• risks presented by the financial company to the financial system, and the extent to which the financial company has benefited, or is likely to benefit, from the orderly liquidation of a financial company under
Title II (compared to a liquidation under the US Bankruptcy Code or other liquidation scheme), including:

- the amount, categories, and concentration of a financial company and its affiliates’ on- and off-balance sheet assets and liabilities;
- the activities and relevant market share of the financial company;
- the extent to which the financial company is leveraged;
- the amount, maturity, volatility, and stability of the financial company’s liabilities and its reliance on short-term funding;
- the stability and variety of the financial company’s sources of funding;
- the financial company’s importance to households, businesses, and governments as a source of credit and liquidity to the financial system; and
- the extent to which the financial company manages, rather than owns, assets, and the extent to which any ownership is diffuse.

- risks presented by the financial company; and
- other risk-related factors the FDIC and FSOC deem appropriate.

I. Studies

Title II of the Dodd-Frank Act requires the following studies to be conducted and reported to Congress:

1. Study on Secured Creditor Haircuts

Not later than one year after enactment of the Dodd-Frank Act, the FSOC shall conduct a study and submit a report to Congress evaluating the importance of maximizing protection of US taxpayers and promoting market discipline with respect to the treatment of fully secured creditors under the orderly liquidation authority. The Miller-Moore amendment included in the original House-passed bill granted the FDIC the authority to impose haircuts of up to 10% on certain secured creditors providing short-term funding. The Dodd-Frank Act did not include this amendment or a comparable provision, but rather included this study to further review this concern.

2. Study on Bankruptcy Processes for Financial and Nonbank Financial Institutions

Not later than one year after enactment of the Dodd-Frank Act, and every year thereafter for the next four years, the FRB, in consultation with the Administrative Office of the US Courts, shall conduct a study and submit a report
3. **Study on International Coordination Relating to Bankruptcy Process for Nonbank Financial Institutions**

Not later than one year after enactment of the Dodd-Frank Act, the FRB, in consultation with the Administrative Office of the US Courts, shall conduct a study and submit a report to Congress regarding international coordination relating to the resolution of systemically significant nonbank financial companies under the US Bankruptcy Code and applicable foreign law.

J. **Effective Date**

While there are future rulemakings and studies required, the general provisions of Title II are effective one day after the date of enactment of the Dodd-Frank Act. Therefore, the orderly liquidation authority would be available immediately in the event that a systemically significant financial company experiences financial difficulty.

A. Summary

Title III of the Dodd-Frank Act makes two sets of major changes to the federal regulation of financial institutions:

- First, although Title III retains the thrift charter, it abolishes the OTS and transfers its regulatory responsibilities and powers with respect to state and federal thrifts, and thrift holding companies and their non-depository institution subsidiaries, to the other federal bank regulators. However, the final legislation does not include earlier proposals that would have resulted in a much broader restructuring of the non-thrift responsibilities of the federal banking agencies.

- Second, Title III makes significant changes to the FDIA, including a permanent increase in the standard maximum deposit insurance amount to $250,000, a two-year mandatory extension of the TAG Program’s unlimited insurance coverage for noninterest-bearing transaction accounts, and substantial revisions to the FDIC assessment regime.

Title III also includes several discrete measures that will be of interest to regulated depository institutions and other financial services companies, including:

- enhanced agency authority to impose and collect examination and other fees from regulated entities; and
- new diversity and inclusion mandates that will impact both the federal banking agencies and the institutions they regulate.

B. Transfer of OTS Authority to the OCC, FDIC, and FRB

The Dodd-Frank Act abolishes the OTS and provides for the transfer of its functions and authorities to the OCC, FDIC, and FRB. Although the Dodd-Frank Act eliminates the OTS as a federal regulator, it does not eliminate the federal thrift charter as had been proposed originally by the Obama Administration and included in the original Senate-passed bill. The Dodd-Frank Act requires that the transfer of OTS powers take place within one year of enactment, with the possibility of a six-month extension.
1. **Transfer of OTS Federal Thrift and Rulemaking Authority to the OCC**

The OCC succeeds to the OTS as the primary regulator of federal thrifts. All OTS functions related to federal thrifts and OTS rulemaking authority over all thrifts (including state-chartered thrifts) are assigned to the OCC. The Dodd-Frank Act requires further that the Comptroller designate a Deputy Comptroller for the supervision and examination of federal thrifts, although it does not expressly mandate the establishment of a separate “thrift division” within the OCC as the original House-passed bill would have.

2. **Transfer of OTS Authority to the FDIC**

The FDIC succeeds to the OTS as the primary federal regulator of state thrifts.

3. **Transfer of OTS Thrift Holding Company Authority to the FRB**

The FRB succeeds to the OTS as the primary regulator of thrift holding companies. Specifically, the Dodd-Frank Act transfers to the FRB (i) all functions of the OTS related to the supervision of thrift holding companies and non-depository institution subsidiaries of thrift holding companies, and (ii) all rulemaking authority of the OTS related to thrift holding companies. In addition, the Dodd-Frank Act transfers to the FRB all OTS rulemaking authority under Section 11 of HOLA, related to transactions with affiliates (including the flat prohibition on loans to affiliates engaged in non-financial activities) and extensions of credit to executive officers, directors, and principal shareholders, and under Section 5(q) of HOLA, related to tying arrangements.

4. **Transfer Date; Elimination of the OTS**

The transfer of OTS powers will take place one year after the date of enactment of the Dodd-Frank Act, and the OTS will be officially abolished 90 days later. However, the Dodd-Frank Act authorizes the Secretary, in consultation with the OCC, OTS, FRB, and FDIC, to extend the transfer date for up to an additional six months by providing notice to the SBC and HFSC.

The Dodd-Frank Act includes detailed transitional provisions providing for the transfer of OTS personnel, funds, and property to the appropriate succeeding agencies. These provisions include numerous protections for OTS employees, such as a requirement, to the extent practicable, that each transferred employee be placed in a position at the succeeding agency responsible for the same functions and duties as the transferred employee had at the OTS.
5. Replacement of OTS Director on FDIC Board

As of the transfer date, the position on the five-member FDIC Board of Directors currently occupied by the Director of the OTS will be transferred to the Director of the BCFP. This change could have implications for the choice of successors to FDIC Chairman Bair and Comptroller Dugan in light of the statutory prohibition on more than three members of the FDIC board being from the same political party.

6. Pending OTS Matters

Savings provisions included in the Dodd-Frank Act provide for the continuation of lawsuits involving the OTS, as well as existing OTS orders, resolutions, agreements, and regulations. The OCC, FRB, and FDIC are required by the transfer date to publish a list of existing OTS regulations that will be enforced by each agency. The OCC and FDIC are required to consult with one another regarding which current OTS regulations each will enforce.

Proposed regulations of the OTS published before the transfer date will be considered proposals of the appropriate succeeding agency. Any regulation issued in final form, but yet to take effect as of the transfer date, will take effect according to its terms as a regulation of the appropriate agency.

7. Branching Powers of Thrifts That Convert to Bank Charters

The Dodd-Frank Act permits any thrift that converts to a bank charter to continue to operate branches and agency offices in existence prior to the charter conversion. The most significant practical effect of this provision is to permit converted thrifts to retain branches in states in which the thrift did not have a branch prior to enactment of GLBA. Moreover, the Dodd-Frank Act permits converted thrifts to establish, acquire, and operate additional branches and agency offices within any state where the thrift operated a branch prior to the charter conversion, provided that such branching is permitted for state-chartered banks.

C. Deposit Insurance Reforms

The Dodd-Frank Act contains significant changes to the existing federal deposit insurance regime, including several measures adopted by the Conference Committee that were not included in either the original House-passed or Senate-passed bill.
1. **Permanent Increase of the Standard Maximum Deposit Insurance Amount**

The Dodd-Frank Act amends the FDIA to make permanent the increase in the standard maximum deposit insurance amount from $100,000 to $250,000. Although it generally had been expected that the temporary increase in FDIC coverage to $250,000 – enacted during the financial crisis and scheduled to expire on December 31, 2013 – would at some point be extended or made permanent, this provision was not in either the original House-passed or Senate-passed bill but was added by the Conference Committee. The increase is retroactive, covering depositors in any institution for which the FDIC was appointed receiver or conservator on or after January 1, 2008. Uninsured depositors of IndyMac Bank, FSB, which failed on July 11, 2008, are the principal beneficiaries of this retroactive application of the coverage increase.

The Dodd-Frank Act similarly amends the FCUA to increase the standard maximum share insurance amount applicable to credit unions from $100,000 to $250,000.

2. **Extension of Full Insurance Coverage for Noninterest-Bearing Transaction Accounts**

In another measure adopted by the Conference Committee despite not having been included in either the original House-passed or Senate-passed bill, the Dodd-Frank Act extends full deposit insurance coverage for noninterest-bearing transaction accounts until December 31, 2012. The new expiration date reflects a compromise reached in conference, as the House Conferees had proposed a permanent extension. The effect of this provision is to codify and extend the FDIC’s existing TAG Program for two years beyond its current sunset date of December 31, 2010. However, the new statutory provisions do not completely align with the existing FDIC TAG Program. For example, the statutory program is mandatory rather voluntary, and low-interest paying NOW accounts are not expressly covered under the Dodd-Frank Act provision.

3. **Revised Definition of Assessment Base**

The Dodd-Frank Act requires the FDIC to amend its regulations to define the “assessment base” against which deposit insurance premiums are calculated as a depository institution’s “average consolidated total assets” less the institution’s “average tangible equity” (with an additional deduction to be determined by the FDIC for custodial and banker’s banks).
Although prior law provided the FDIC with sufficient flexibility to adopt an asset-based assessment regime, the FDIC has always used a deposit-based regime. By mandating that the FDIC now determine the assessment base according to total assets rather than deposit liabilities, this provision is likely to result in higher premiums for larger, more complex institutions that tend to rely more heavily on funding sources other than insured deposits. The Dodd-Frank Act does not specify any deadline for the FDIC to change to an asset-based assessment regime.

The Dodd-Frank Act also eliminates a provision of the FDIA that had prohibited the exclusion of insured depository institutions from the FDIC’s lowest risk-based assessment category based solely upon size.

4. **Increase in the Minimum Reserve Ratio**

The Dodd-Frank Act increases the minimum reserve ratio that may be established by the FDIC Board of Directors from the existing 1.15 percent of estimated deposits to 1.35 percent of estimated deposits (or a “comparable percentage” of the asset-based assessment base described above). However, the Dodd-Frank Act requires the FDIC to “offset” the effect of this increase in the minimum reserve ratio when setting assessments for insured depository institutions with less than $10 billion in total consolidated assets. Although the provisions are not a model of clarity, the intent clearly is to impose higher FDIC insurance premiums only on larger banks. The FDIC has until September 30, 2020, to grow the DIF to the new floor of 1.35 percent of estimated deposits.

This change in the minimum reserve ratio, which was not part of either the original House-passed or Senate-passed bill and was not included in the initial bill reported by the Conference Committee, was added to the Dodd-Frank Act when the conference reconvened on June 29 to address objections from several key Senators to a special levy on large banks that had been added in the final stages of the conference to address the costs of the Dodd-Frank Act.

5. **FDIC Authority to Suspend Payment of Rebates**

In a measure intended to mitigate the procyclical nature of FDIC assessments, the Dodd-Frank Act provides the FDIC with discretionary authority to suspend or limit rebates to insured depository institutions when the reserve ratio exceeds 1.5 percent of estimated insured deposits. These rebates were mandatory under prior law. In addition, the Dodd-Frank Act eliminates provisions of the FDIA that permitted rebates when the reserve ratio fell between 1.35 percent and 1.5 percent of estimated insured deposits.
D. Additional Measures

1. Agency Funding Authority

The Dodd-Frank Act broadens somewhat the existing authority of the FRB, OCC, and FDIC to collect assessments, fees, or other charges from regulated entities in order to fund examinations and pay other costs deemed “necessary or appropriate” to carrying out their responsibilities.

In the case of the OCC and the FDIC, the new authority to charge fees and make assessments generally overlaps with their existing authority, although the new FDIC authority extends beyond examination fees (which the FDIC already had authority to impose but traditionally has not done so).

On the other hand, the Dodd-Frank Act requires that the FRB collect assessments, fees, or other charges equal to the total amount it estimates is necessary or appropriate to carry out its supervisory and regulatory responsibilities for large bank and thrift holding companies and nonbank financial companies. The FRB’s authority in this regard (and the expenses it is required to recover) is limited to bank and thrift holding companies with $50 billion or more in consolidated assets and systemically significant nonbank financial companies supervised by the FRB pursuant to Title I of the Dodd-Frank Act.

2. Establishment of Offices of Minority and Women Inclusion

In another measure that was not included in either the original House-passed or Senate-passed bill, the Dodd-Frank Act requires the establishment of an Office of Minority and Women Inclusion in each of the bank regulatory agencies; the BCFP; Treasury; each regional Federal Reserve Bank; the SEC; the NCUA; and the FHFA. Among other things, these Offices are responsible for developing standards and procedures to promote the inclusion of minorities, women, and minority- and women-owned businesses in agency contracting activities and, significantly, for assessing the diversity policies and practices of regulated entities.
TITLE IV – REGULATION OF ADVISERS TO HEDGE FUNDS AND OTHERS

A. Summary

Most notably, the Dodd-Frank Act eliminates the “private adviser exemption” to registration under the Advisers Act and will require many investment advisers (who are currently exempt from registration) to register with the SEC. Among other changes, the Dodd-Frank Act also revises the recordkeeping requirements applicable to investment advisers to private funds, amends the definitions of “accredited investor” and “qualified client,” and provides limited exemptions from registration under the Advisers Act for:

- investment advisers to venture capital funds;
- “foreign private advisers;”
- certain private fund advisers;
- advisers to small business investment companies;
- certain “commodity trading advisors” who advise private funds; and
- mid-sized investment advisers (advisers with assets under management between $25 million and $100 million).

B. Elimination of Private Adviser Exemption

The Dodd-Frank Act eliminates the current version of Section 203(b)(3) of the Advisers Act (the “private adviser exemption”), which exempted from registration an investment adviser who, during the preceding twelve months, had fewer than 15 clients and neither held himself out generally to the public as an investment adviser nor acted as an investment adviser to any registered investment company or business development company. While the US Court of Appeals for the DC Circuit’s decision in Goldstein v. SEC allowed many investment advisers to private funds to rely on the private adviser exemption, by eliminating this exemption, the Dodd-Frank Act will require many of those investment advisers to register with the SEC.

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1 In Goldstein v. SEC, the US Court of Appeals for the DC Circuit struck down the SEC’s hedge fund adviser registration rule, which required US hedge fund advisers to “look through” the hedge fund and count each investor in the hedge fund, rather than only the hedge fund itself, as a “client” for purposes of applying the private adviser exemption.
C. Limited Exemptions from Registration

1. Advisers to Venture Capital Funds

While the original Senate-passed and House-passed bills diverged on their treatment of investment advisers to “private equity funds” (and an exemption from registration for investment advisers to “private equity funds” was removed from the Dodd-Frank Act by the Conference Committee), both the original Senate-passed and House-passed bills contained an exemption from registration for investment advisers to “venture capital funds.” Under the Dodd-Frank Act:

- investment advisers who act as investment advisers solely to one or more “venture capital funds” are exempt from registration under the Advisers Act;
- the SEC will, within 1 year after the date of enactment of the Dodd-Frank Act, issue final rules to define the term “venture capital fund;” and
- the SEC will require such investment advisers to maintain and provide to the SEC certain records and reports (as the SEC determines necessary or appropriate in the public interest or for the protection of investors).

2. Foreign Private Advisers

The Dodd-Frank Act exempts from registration under the Advisers Act a “foreign private adviser,” which the Dodd-Frank Act defines as any investment adviser who:

- has no place of business in the United States;
- has, in total, fewer than 15 clients and investors in the United States in private funds advised by the investment adviser;
- has aggregate assets under management attributable to clients in the United States and investors in the United States in private funds advised by the investment adviser of less than $25 million (or such higher amount as determined by the SEC); and
- neither holds itself out generally to the public in the United States as an investment adviser nor advises a business development company or a SEC-registered investment company.

While earlier drafts of the original Senate-passed and House-passed bills only referenced “clients,” the inclusion of “investors” (in addition to “clients”) in the definition of a “foreign private adviser” in the Dodd-Frank Act will preclude many

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2 The explicit language of the Dodd-Frank Act requires that the investment adviser not act as a company that has elected to be a business development company; however, we have assumed that the intention was instead that the investment adviser not advise a company that has elected to be treated as a business development company.
non-US investment advisers from taking advantage of this exemption (as they cannot rely on Goldstein v. SEC to avoid taking into account US investors in the private funds that they advise).

3. **Advisers to Private Funds**

The Dodd-Frank Act directs the SEC to provide an exemption from registration under the Advisers Act for any investment adviser to “private funds,” which the Dodd-Frank Act defines as an issuer that would be an investment company but for Section 3(c)(1)\(^3\) or 3(c)(7)\(^4\) of the ICA, if such investment adviser acts solely as an investment adviser to private funds and has assets under management in the United States\(^5\) of less than $150 million. The Dodd-Frank Act also directs the SEC to require such investment advisers to maintain records and provide reports as the SEC determines necessary or appropriate in the public interest or for the protection of investors.

4. **Advisers to Small Business Investment Companies**

The Dodd-Frank Act exempts from registration any investment adviser who does not advise a company that has elected to be treated as a business development company and who solely advises:

- small business investment companies that are licensees under SBIA;
- entities that have received from the SBA notice to proceed to qualify for a license as a small business investment company under SBIA, which notice or license has not been revoked; or
- applicants that are affiliated with 1 or more licensed small business investment companies and that have applied for another license under SBIA, which application remains pending.

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\(^3\) Section 3(c)(1) of the ICA excepts from the definition of an “investment company” any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than one hundred persons and which is not making and does not presently propose to make a public offering of its securities.

\(^4\) Section 3(c)(7) of the ICA excepts from the definition of an “investment company” any issuer, the outstanding securities of which are owned exclusively by persons who, at the time of acquisition of such securities, are “qualified purchasers” (as defined in Section 2(a)(51) of the ICA), and which is not making, and does not at that time propose to make, a public offering of such securities.

\(^5\) The phrase “assets under management in the US” is not defined in the Advisers Act (nor the Dodd-Frank Act), and thus it is yet to be determined what “assets under management in the U.S.” will mean in this context.

\(^6\) The explicit language of the Dodd-Frank Act requires that the investment adviser not have elected to be regulated as a business development company; however, we have assumed that the intention was instead that the investment adviser not advise a company that has elected to be treated as a business development company.
5. **“Commodity Trading Advisors” Who Advise Private Funds**

The Dodd-Frank Act exempts from registration under the Advisers Act an investment adviser who is registered with the CFTC as a “commodity trading advisor” and advises a private fund. However, if, after the date of enactment of the Dodd-Frank Act, the business of that investment adviser becomes predominantly the provision of securities-related advice, then that investment adviser will be required to register with the SEC.

6. **Mid-Sized Investment Advisers**

The Dodd-Frank Act provides that an investment adviser may not register with the SEC if the investment adviser has between $25 million and $100 million in assets under management, is otherwise required to register with its home state, and would be subject to examination by its home state. However, if an investment adviser with $25 million or more assets under management would be required to register with 15 or more states, the investment adviser may register with the SEC. The Dodd-Frank Act does not alter the current rule that investment advisers with assets under management of less than $25 million (who are not investment advisers to a SEC-registered investment company) are not required to register with the SEC. The Dodd-Frank Act also directs the SEC to take into account systemic risk when developing rules applicable to mid-sized investment advisers.

i. **Revised Intrastate Exemption**

The Dodd-Frank Act revises the intrastate exemption in the Advisers Act (which exempts from registration an investment adviser, all of whose clients are residents of the investment adviser’s home state) to exclude investment advisers to private funds.

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7 “Predominantly” is not defined in the Advisers Act (nor the Dodd-Frank Act), and thus it is yet to be determined what “predominantly” will mean in this context.

8 Excluding investment advisers who advise SEC-registered investment companies or business development companies (while the Dodd-Frank Act could be read to require that, in order to avail itself of the exemption, the investment adviser not act as a company that has elected to be a business development company, we have assumed that the intention was instead that the investment adviser not advise a company that has elected to be treated as a business development company).

9 The SEC may raise this $100 million assets under management threshold.
ii. **Family Office Exception**

The Dodd-Frank Act includes an exception from the definition of an “investment adviser” for any “family office” (to be defined by the SEC, subject to certain restrictions). The Dodd-Frank Act also provides that certain family offices excepted from the definition of an “investment adviser” will nonetheless be deemed to be investment advisers for purposes of Section 206(1), (2) and (4) of the Advisers Act (which generally provides that it is unlawful for an investment adviser to defraud any client or prospective client).

D. **Other Provisions**

1. **Recordkeeping by Advisers to Private Funds**

The Dodd-Frank Act deems the records and reports of a private fund advised by a SEC-registered investment adviser to be the records and reports of the investment adviser, and specifically empowers the SEC to require SEC-registered investment advisers to maintain records and file reports (including descriptions of trading and investment positions and use of leverage) regarding private funds advised by the investment adviser as necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systematic risk by the FSOC.

2. **Disclosure of Information; Confidentiality**

The Dodd-Frank Act requires that the SEC share with the FSOC all records of private funds advised by SEC-registered investment advisers “as the [FSOC] may consider necessary for the purpose of assessing the systematic risk posed by a private fund,” subject to a requirement that the FSOC maintain the confidentiality of information received. In addition to the FSOC, the Dodd-Frank Act also permits disclosure of such information to other federal departments, agencies, or SROs, subject to certain confidentiality requirements. Any proprietary information of an investment adviser (defined to include, among other things, the investment and trading strategies of an investment adviser) is subject to the same limitations on public disclosure as any facts ascertained during an SEC examination. The Dodd-Frank Act also amends Section 210(c) of the Advisers Act to provide for an exception for assessing potential systematic risk (to the general rule that investment advisers will not be required to disclose the identity of their clients).
3. **Definition of “Client” for Anti-Fraud Purposes**

The Dodd-Frank Act includes a provision that precludes the SEC from defining the term “client” for purposes of Section 206(1) and (2) of the Advisers Act to include an investor in a private fund managed by an investment adviser, if such private fund has entered into an advisory contract with such adviser. This provision effectively limits the SEC’s ability to enforce the anti-fraud provisions of the Advisers Act with respect to investors in private funds to Section 206(4) and the rules thereunder (namely Rule 206(4)-8, which prohibits investment advisers to pooled investment vehicles from defrauding investors or prospective investors in those vehicles).

4. **Custody of Client Assets**

While the original House-passed bill contained certain revisions to Section 206(4), the Dodd-Frank Act does not include any substantive amendments to the custody requirements applicable to SEC-registered investment advisers. The Dodd-Frank Act does direct the GAO to conduct a study on the compliance costs associated with Rules 204-2 and 206(4)-2 under the Advisers Act, and the additional costs associated with the elimination of Rule 206(4)-2(b)(6) under the Advisers Act (relating to operational independence).

5. **Net Worth Standard for “Accredited Investors”**

In order to satisfy the “private placement” requirement of Sections 3(c)(1) or 3(c)(7) of the ICA, many private funds avail themselves of Regulation D under the Securities Act, which generally requires that investors be “accredited investors.” Currently, the net worth standard for an “accredited investor” who is a natural person is $1 million (including all assets). The Dodd-Frank Act directs the SEC to adjust this net worth standard so that the individual net worth of any natural person (or joint net worth with the spouse of that person) is more than $1 million, excluding the value of the primary residence of such natural person. The Dodd-Frank Act also directs the SEC to periodically review (and adjust) the definition of “accredited investor,” as such term applies to natural persons.

6. **Qualified Client Test**

Under Section 205 of the Advisers Act (and Rule 205-3 thereunder), SEC-registered investment advisers may only charge performance-based fees to “qualified clients” (as defined in Rule 205-3). The Dodd-Frank Act requires the SEC to periodically review (and adjust) the definition of “qualified client,” as such term applies to natural persons.

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10 For a 4 year period after the date of enactment of the Dodd-Frank Act, the net worth standard for a natural person will be $1 million, excluding the value of the natural person’s primary residence.
periodically to adjust for inflation (and round to the nearest $100,000) the dollar amount measures used in the “qualified client” test under Section 205(e) of the Advisers Act.

7. Effect on the CEA

The Dodd-Frank Act includes a savings clause to the effect that the provisions of the Dodd-Frank Act do not affect any of the rights or obligations of any person under the CEA. The Dodd-Frank Act directs the SEC and the CFTC, in consultation with the FSOC, to develop rules to establish the form and content of reports to be filed with the SEC and the CFTC by investment advisers registered under the Advisers Act and the CEA.

8. Studies to be Undertaken

The Dodd-Frank Act requires studies and reports to be undertaken on various topics, including accredited investor status and eligibility to invest in private funds (by the GAO), the formation of an SRO to oversee private funds (by the GAO), and short selling (by the SEC’s Division of Risk, Strategy, and Financial Innovation).

E. Effective Date

Unless otherwise provided, Title IV will become effective one year after the date of enactment of the Dodd-Frank Act.
A. Summary

Historically, the regulation of the insurance industry in the United States has been the province of the states. With the exception of the Liability Risk Retention Act of the 1980s and the post 9/11 backstop that the US government provided to property and casualty insurers under the TRIA, the federal government has played no direct role in the regulation of insurance companies. Other than large insurance firms that could be designated as systemically significant and thus subject to regulation by the FRB, the Dodd-Frank Act does not give the federal government a role in licensing or regulating the insurance industry in the United States, but it does represent an initial step in that direction.

The Dodd-Frank Act establishes the FIO within the Treasury. The scope of the authority of the FIO extends to all lines of insurance except health insurance, most long-term care insurance, and crop insurance. The FIO will be responsible for collecting information, monitoring the insurance industry and making recommendations on modernizing and improving insurance regulation in the United States. Additionally, the Dodd-Frank Act authorizes the FIO to preempt state laws if such laws conflict with the objectives of certain international insurance agreements. The Dodd-Frank Act attempts to create national uniformity in two areas of insurance regulation, the non-admitted insurance market and reinsurance. The Dodd-Frank Act gives large commercial purchasers of insurance a more streamlined route to obtain coverage from non-admitted companies, including companies outside the United States. The Dodd-Frank Act requires credit for reinsurance to be recognized for a ceding company if it is allowed by the ceding company’s domiciliary state, preempts the extraterritorial application of most laws regarding reinsurance from states that are not the ceding company’s domicile, and places the power to regulate reinsurer financial solvency primarily with the reinsurer’s domiciliary state.

The insurance industry should also be aware of the impact of derivatives reform under Title VII of the Dodd-Frank Act. Insurers and reinsurers that use derivatives could be subjected to the requirements of central clearing and exchange trading. The language of Title VII is not definitive as to exactly what derivative products and which users of them will be subject to the enhanced regulation of the Dodd-Frank Act and is still subject to post-passage rulemaking. Notably, Title VII also adds a provision to Section 12 of the CEA stating that a swap shall not be considered to be insurance and may not be regulated as such under state law.
B. Creation of the Federal Insurance Office

The FIO will be headed by a Director, a career civil service position, appointed by the Secretary. The Director is to serve in an advisory capacity on the FSOC. The FIO’s primary functions include the following:

1. Monitoring

- Identify issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system.
- Monitor the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons, have access to affordable insurance products.

2. Advisory

- Recommend that the FSOC designate an insurer, including the affiliates of such insurer, as an entity that should be subject to regulation by the FRB on the basis that such insurer or affiliate presents a potential risk to the financial system.
  - Such regulation could result in, among other things, further federally imposed requirements with respect to enhanced risk-based capital levels, leverage limits, liquidity requirements, credit exposure requirements, concentration limits, enhanced public disclosures, short-term debt limits, overall risk management requirements, and a resolution plan.
- Advise the Secretary on major domestic and prudential international insurance policy issues.

3. Administrative

- Assist in the administration of the terrorism insurance program established pursuant to TRIA.
- Coordinate federal efforts and develop federal policy on prudential aspects of international insurance matters, including representing the United States, as appropriate, before the International Association of Insurance Supervisors (or a successor entity).
- Assist the Secretary in negotiating international agreements.
- Determine whether state insurance measures are preempted by certain types of international insurance agreements, defined as “covered” agreements (see below) entered into between the United States and foreign nations.
• Consult with the states (including state insurance regulators) regarding insurance matters of national importance and prudential insurance matters of international importance.

4. Reports

• Annually, beginning on September 30, 2011, the Director is to make a report to the HFSC and SBC on the insurance industry.
• On September 30, 2012, the Director is required to report to the HFSC and SBC on the breadth and scope of the global reinsurance market and to update that report on January 1, 2013.
• On January 1, 2015, the Director is required to report to both the HFSC and SBC on the impact of the reinsurance provisions of NARRA (discussed below) and on the ability of state regulators to assess reinsurance information for regulated companies in their jurisdiction.
• Not later than 18 months following enactment, the Director is required to submit a report to Congress on how to modernize and improve the system of insurance regulation in the United States. That report is to cover:
  ▪ systemic risk regulation as it pertains to insurance;
  ▪ capital standards and the relationship between capital allocation and liabilities, including standards relating to liquidity and duration risk;
  ▪ consumer protection for insurance products and practices, including gaps in state regulation;
  ▪ the regulation of insurance companies and affiliates on a consolidated basis;
  ▪ international coordination of insurance regulation;
  ▪ the costs and benefits of potential federal regulation of insurance across various lines of insurance (except health);
  ▪ the feasibility of only regulating certain lines of insurance at the federal level while leaving other lines of insurance to be regulated at the state level;
  ▪ the ability of any federal regulation or federal regulators to minimize regulatory arbitrage;
  ▪ the impact that developments in the regulation of insurance in foreign jurisdictions might have on potential federal regulation of insurance;
  ▪ the ability of any potential federal regulation or federal regulator to provide robust consumer protection for policyholders;
  ▪ the potential consequences of subjecting insurance companies to a federal resolution authority, including the impact such authority would have on the operation of state insurance guaranty systems (including the loss of guaranty fund coverage), on policy-holder protection (including the loss of priority status of policy-holder claims), and, in the case of life insurance companies, on the loss of the special account status of...
separate account assets and separate account liabilities, and on the international competitiveness of insurance companies; and
- legislative, administrative, or regulatory recommendations the Director considers to be appropriate to carry out findings contained in the report.

C. Information Collection

In performing its monitoring function, the FIO is authorized to require any insurer (defined as “any entity that writes insurance or reinsures risks and issues contracts or policies in one or more States”) or any “affiliate” of an insurer (defined as “any person who controls, is controlled by, or is under common control with the insurer”) to submit data or information specified by the FIO. “Small” insurers, the definition of which is left to the discretion of the FIO, can be exempted from information reporting obligations; however, it is not clear whether it is intended that the FIO is to exempt small insurers from all information reporting or only from having to respond to certain types of information requests. Before imposing an information reporting obligation on insurers, the FIO is to coordinate with federal and state regulators to determine whether such information may be obtained from such agencies or other public sources. Where possible, the FIO is to obtain information from existing sources rather than impose new reporting obligations on the industry.

1. No Waiver of Privilege

The submission of non-public information to the FIO will not constitute a waiver of any privilege that might otherwise apply to such information. In addition, any preexisting confidentiality agreement that may have applied to information provided to another agency, such as a state regulatory agency, would apply to the FIO as well. The FIO is authorized to share information it obtains with other agencies as long as such agencies enter into an information-sharing agreement that complies with federal law. The sharing of information with another agency under the terms of an information-sharing agreement would not constitute a waiver of any privilege that might otherwise apply to such information.

2. Subpoena Power

The FIO is authorized to issue subpoenas, an unusual authority to be granted to an agency, such as the FIO, that lacks the ability to take enforcement actions. Prior to issuing a subpoena, the Director must make a written finding that the information is required and that the FIO has coordinated with the relevant agencies (presumably to demonstrate that the subpoenaed information cannot be obtained any other way). FIO subpoenas can be enforced by federal district courts.
D. Preservation of States’ Authority to Regulate Insurance

The Dodd-Frank Act generally preserves the ability of state insurance regulators to supervise the business of insurance but authorizes the FIO to preempt state measures that, in the FIO’s judgment, are inconsistent with covered agreements or otherwise result in less favorable treatment of insurers domiciled in foreign jurisdictions that are subject to covered agreements than the treatment accorded to United States insurers that are admitted in the state. Covered agreements are defined in the Dodd-Frank Act as bilateral or multi-lateral agreements entered into between the United States and foreign nations that enable non-US insurance companies to operate in the US insurance market, subject to prudential measures that achieve a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under state regulation.

1. Preconditions for Implementing Preemption Authority

Prior to preempting a state law, the FIO must:

- issue a notice of potential inconsistency to the appropriate state regulator;
- notify and consult with the USTR;
- advise the HFSC and SBC;
- issue a notice in the Federal Register;
- give interested parties an opportunity to comment; and
- establish a reasonable time for the notice to become effective.

State law can only be preempted to the extent that the law conflicts with the subject matter of the relevant international agreement. FIO preemption cannot extend to any state insurance measure that governs:

- rates
- premiums
- underwriting
- sales practices
- coverage requirements
- the application of state antitrust laws or state capital or insolvency requirements (unless such requirements result in less favorable treatment of a non-US insurer versus a US insurer)

A notice regarding the decision to preempt state law must be published in the Federal Register. The FIO’s decision to preempt a state law can be appealed to a federal court.
E. Authority of the FIO to Negotiate International Insurance Agreements

The Dodd-Frank Act establishes authority at the federal level for the USTR and the Secretary to negotiate covered agreements.

1. Authority of the Secretary and USTR

Prior to negotiating an international insurance agreement, the Secretary and the USTR must consult with the HFSC and SBC and brief them on the nature of the agreement, the purposes it will advance, and its impact on state law. Agreements cannot go into effect for 90 days following their submission to the HFSC and SBC, and that time limit can only be triggered during a period when Congress is in session.

F. Regulatory Reform Governing Non-Admitted Insurance Coverage

The Dodd-Frank Act incorporates, as Subtitle B of Title V, NARRA, a bill that was passed by the House of Representatives in 2009 and had been pending in the Senate. NARRA is intended to streamline the patchwork scheme of existing regulation in a manner that is designed to increase market choice by making it easier for large commercial purchasers to obtain insurance from companies not admitted to write insurance in their state. Subtitle B of Title V takes effect 12 months after the date of enactment of the Dodd-Frank Act.

1. Treatment of Premium Tax Payments

Under the Dodd-Frank Act, only the home state of an insured party may impose a premium tax on insurance obtained from a non-admitted insurer. States may enter into compacts to allocate among them the premium taxes paid to a home state. Congress expresses the clear intent in the Dodd-Frank Act that states are to adopt, on a nationwide basis, uniform requirements, forms, and procedures that provide for the reporting, payment, collection, and allocation of premium taxes for non-admitted insurance.

2. Regulation of Non-Admitted Insurance by Home State of Insured Party

The Dodd-Frank Act further provides that the placement of non-admitted insurance is only to be subject to regulation by the home state of the insured party, and no state other than the insured’s home state may require a surplus lines broker to be licensed in that state in order to sell, negotiate or solicit non-
admitted insurance. With the exception of workers’ compensation insurance, any attempts by other states to regulate non-admitted insurance activities are preempted. In addition, two years following enactment, no state can collect fees relating to the licensing of surplus lines brokers, unless that state is participating in the national insurance producer database of the NAIC or an equivalent uniform database.

States additionally are prohibited from imposing eligibility requirements or criteria on US domiciled non-admitted insurers, unless the state has adopted uniform requirements, forms and procedures in accordance with a nationwide system described above. States also are barred from prohibiting a surplus lines broker from placing non-admitted insurance with, or procuring non-admitted insurance from, a non-admitted insurer domiciled outside the United States if the non-admitted insurer is listed on the Quarterly Listing of Alien Insurers maintained by the NAIC.

3. Streamlined Application for Commercial Purchasers

Surplus lines brokers that place coverage with a non-admitted insurer on behalf of purchasers that meet the statute’s definition of “exempt commercial purchaser” are not required to satisfy any state requirement to conduct a due diligence search to determine if the insurance can be obtained from an admitted insurer if:

- the broker placing the insurance has informed the commercial purchaser that such insurance may or may not be available from the admitted market that may provide greater protection with more regulatory oversight
- the commercial purchaser has subsequently requested the non-admitted coverage from the broker in writing

For these purposes, an exempt commercial purchaser is defined as:

- a purchaser of insurance who employs or retains a qualified risk manager to negotiate insurance coverage;
- has paid over $100,000 in property and casualty insurance premiums in the past 12 months; and
- meets at least one of the following criteria:
  - possesses a net worth of $20 million;
  - generates $50 million in annual revenue;
  - employs more than 500 full-time employees or is a member of an affiliated group that employs more than 1,000 full-time employees;
- is a not-for-profit organization or public entity that generates annual budgeted expenditures of $30 million; or
- is a municipality with a population in excess of 50,000.

4. **GAO Study of Non-Admitted Market**

Within 30 months following enactment of the Dodd-Frank Act, the Comptroller General is directed to study, in consultation with the NAIC, the impact that the changes mandated by Title V of the Dodd-Frank Act have on the size and market share of the non-admitted market. Specifically, the study is to address:

- the change in the size and market share of the non-admitted insurance market and in the number of insurance companies and insurance holding companies providing such business in the 18-month period that begins upon enactment;
- the extent to which insurance coverage typically provided by the admitted insurance market has shifted to the non-admitted insurance market;
- the consequences of any change in the size and market share of the non-admitted insurance market, including differences in the price and availability of coverage available in both the admitted and non-admitted insurance markets;
- the extent to which insurance companies and insurance holding companies that provide both admitted and non-admitted insurance have experienced shifts in the volume of business between admitted and non-admitted insurance; and
- the extent to which there has been a change in the number of individuals who have non-admitted insurance policies, the type of coverage provided under such policies, and whether such coverage is available in the admitted insurance market.

G. **Regulatory Reform Governing Reinsurance and Reinsurance Agreements**

The Dodd-Frank Act contains several provisions that preempt state law governing reinsurance arrangements. In this regard, the Dodd-Frank Act provides that if the state of domicile of a ceding insurer (the insurer purchasing the reinsurance) is NAIC-accredited or has financial solvency standards substantially similar to those mandated by the NAIC, and recognizes credit for reinsurance for the insurer’s ceded risk, then no other state may deny such credit for reinsurance. In addition, all laws, regulations or actions on the part of a state that is not the domiciliary state of a ceding insurer, except those having to do with taxes, are preempted under Title V of the Dodd-Frank Act, if they:
• restrict or eliminate the rights of the ceding insurer or the assuming insurer to resolve disputes pursuant to contractual arbitration clauses to the extent such clauses are not inconsistent with the provisions of Title 9, United States Code;
• require that a certain state’s law is to govern the reinsurance contract, disputes arising under the reinsurance contract, or requirements of the reinsurance contract;
• attempt to enforce a reinsurance contract on terms different than those set forth in the contract itself; or
• otherwise apply the laws of the state to reinsurance agreements of ceding insurers not domiciled in that state.

1. Regulation of Reinsurer Solvency

The Dodd-Frank Act provides that states that are NAIC accredited or have financial solvency requirements substantially similar to those imposed by the NAIC are solely responsible for regulating the financial solvency of reinsurers domiciled in their state. In addition, no state may require a reinsurer to file financial information beyond that which the reinsurer is required to file with its domiciliary state. Non-domiciliary regulators are permitted to receive copies of information filed with domiciliary state regulators.
A. Summary

Title VI includes a broad range of measures central to the Dodd-Frank Act’s purpose of establishing a more robust regulatory framework for depository institutions, bank and thrift holding companies, and other financial institutions active in the United States, as well as their owners. It supplements Title I’s framework for heightened prudential standards for systemically significant companies and Title I’s other provisions applicable to depository institution holding companies more generally, such as the capital requirements in the Collins Amendment.

Among the most controversial, complex and consequential aspects of the Dodd-Frank Act, the “Volcker Rule” provisions (named for former FRB Chairman Paul Volcker who, as Chairman of President Obama’s Economic Recovery Advisory Board, was the principal catalyst behind the rule) broadly restrict banking entities from engaging in proprietary trading and private fund sponsorship, management, and investment activities. Those general prohibitions, however, are subject to a long list of exemptions and limits that, along with the prohibitions themselves, will need to be fleshed out through the regulatory process. None of the Volcker Rule prohibitions take effect before the earlier of two years after enactment or 12 months after the issuance of final rules, and there are additional phase-in periods for certain restrictions. As a result, the meaning and practical effect of many of the Volcker Rule provisions will be debated, clarified, and refined over the coming months and years.

In addition to the Volcker Rule, Title VI of the Dodd-Frank Act includes a variety of other significant regulatory provisions. These provisions include:

- a moratorium on the establishment or acquisition of industrial loan companies, credit card banks and other “nonbank banks” controlled by commercial firms and a study on their future;
- authorization of de novo interstate branching for domestic and non-US banks alike;
- authorization of interest-bearing commercial checking accounts;
- enhancements to the framework for supervision and examination of bank and thrift holding companies and their nonbank subsidiaries;
• new concentration limits for mergers and acquisitions involving depository institutions;
• tighter lending limits and restrictions on affiliate transactions; and
• changes to the regulation of grandfathered unitary thrift holding companies.

B. The Volcker Rule

1. Ban on Proprietary Trading and Certain Relationships with Private Funds

Subject to a number of key exemptions, the Volcker Rule bans “banking entities” as defined in Section 619 of the Dodd-Frank Act from:

• engaging in proprietary trading; or
• acquiring or retaining any equity, partnership, or other ownership interest in or sponsoring a hedge fund or a private equity fund.

For systemically important nonbank financial companies supervised by the FRB, which are not covered by the ban, the Volcker Rule requires FRB rulemaking to impose additional capital requirements and other quantitative limits with respect to the same proprietary trading and private fund activities and investments.

2. Covered Entities

i. Banking Entities

The basic prohibitions of the Volcker Rule apply to “banking entities,” which are defined to include any insured depository institution, any company that controls an insured depository institution or that is treated as a BHC under the BHCA, and any subsidiary or affiliate of those entities. Thus, the prohibitions would apply to:

• FDIC-insured commercial banks, thrifts, and industrial loan companies (with an exception for insured depository institutions that function solely in a trust or fiduciary capacity);
• any company that controls those depository institutions, regardless of the depository institution’s size;
• any non-US bank (and any parent company) that has a US branch, agency, commercial lending company or insured depository institution subsidiary; and
• any subsidiary of the foregoing entities.
ii. **Nonbank Financial Companies**

Although not subject to the prohibitions of the Volcker Rule, nonbank financial companies that are engaged predominantly in financial activities and have been designated as “systemically important” by the FSOC pursuant to Title I of the Dodd-Frank Act will be subject to yet-to-be-specified additional capital requirements and other quantitative limits in connection with activities and investments covered by the Rule.

3. **Ban on Proprietary Trading**

i. **Covered Instruments**

The Volcker Rule ban on proprietary trading by banking entities applies to any security, derivative, or future, or option on any of the foregoing, or any other security or financial instrument designated by the federal banking agencies, the SEC, and the CFTC. It does not apply to commodities such as precious or base metals, or energy or agricultural products, nor does it apply to foreign exchange or loans.

ii. **Covered Activities**

Proprietary trading subject to the ban consists of “engaging as a principal for the trading account” of a banking entity in any transaction to buy or sell, or otherwise acquire or dispose of, any covered instrument. The “trading account” consists of any account used for acquiring or taking positions in covered instruments “principally for the purpose of selling in the near term.” Covered instruments held for investment, as opposed to trading, are not covered by the ban.

4. **Exemptions from the Ban on Proprietary Trading**

i. **Generally Applicable Exemptions**

Notwithstanding the general prohibitions of the Volcker Rule, the Dodd-Frank Act includes a laundry list of exemptions termed “permitted activities.” Four exemptions from the proprietary trading ban are generally available to all banking entities, including:

- transactions in US government or agency obligations, obligations of the GSEs, and obligations of any state or political subdivision;
- transactions in securities and other financial instruments in connection with underwriting or market-making activities, to the
extent those activities are designed not to exceed the “reasonably expected near term demands” of clients, customers, or counterparties;

- risk-mitigating hedging activities in connection with individual or aggregate positions, contracts, or other holdings of a banking entity; and

- transactions in securities and other financial instruments on behalf of customers.

ii. Exemption for Insurance Companies

The Dodd-Frank Act exempts from the proprietary trading ban transactions in securities and other financial instruments by a regulated insurance company, or its affiliate, for the general account of the insurance company, subject to compliance with applicable state insurance laws. The exemption would not be available if the federal banking agencies (which generally have no supervisory responsibility for insurance companies), after consultation with the FSOC and the relevant state insurance commissioner(s), determine jointly that a particular state insurance law is insufficient to protect the banking entity (i.e., the insurance company and its affiliates), or the financial stability of the United States.

iii. Exemption for Offshore Trading Activities

The Dodd-Frank Act also exempts proprietary trading conducted by a banking entity pursuant to Section 4(c)(9) or 4(c)(13) of the BHCA, but only if the trading occurs “solely outside of the United States” and the banking entity is not directly or indirectly owned or controlled by a banking entity organized under US or state law. The latter condition means that US banking groups and their non-US affiliates will be subject to the ban on a global basis. Thus, the offshore trading exemption would not permit a US banking entity to “push out” otherwise prohibited trading to an offshore subsidiary or affiliate, because any subsidiary or affiliate would, by definition, be controlled by a banking entity organized under US law.

Because non-US banks with US banking offices and their worldwide subsidiaries are banking entities subject to the prohibitions, the scope of this exemption will also be crucial in determining the extraterritorial reach of the Volcker Rule. The non-US subsidiaries and offices of non-US banking organizations will be eligible for the offshore exemption subject to the FRB’s implementation of the BHCA exemptions and the statutory term “solely” (which makes the Volcker offshore exemption narrower...
than the BHCA exemptions). For example, depending on how the FRB interprets these conditions, the Volcker Rule could restrain the ability of non-US banking entities to trade with counterparties or on exchanges located in the United States, through US affiliates or otherwise.

5. Ban on Certain Relationships with Hedge Funds and Private Equity Funds

i. Covered Funds

The ban on certain relationships with “hedge funds” and “private equity funds” applies to any fund that relies on either Section 3(c)(1) (the exemption for funds with less than 100 US beneficial owners) or 3(c)(7) (the exemption for funds with owners who meet the definition of “qualified purchasers,” principally institutions and individuals with large investment portfolios) of the ICA for its exemption from registration under that Act, and similar funds as are designated by the agencies. Private funds not ordinarily considered to be the market equivalent of hedge funds or private equity funds, but which rely on either 3(c)(1) or 3(c)(7), could be covered. For example, the ban may apply to collateralized debt obligations or other bank loan funds and securitization special purpose entities that rely on these exemptions, although the Dodd-Frank Act includes what appears to be a blanket exception for a banking entity’s sale or securitization of loans “in a manner otherwise permitted by law.”

ii. Covered Activities

The Volcker Rule generally prohibits a banking entity from investing in or “sponsoring” a covered fund. A banking entity “sponsors” a covered fund by (i) serving as a general partner, managing member, or trustee of the fund; (ii) selecting or controlling (or having employees, officers, or directors, or agents who constitute) a majority of the directors, trustees, or management of the fund; or (iii) sharing with the fund for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name. The prohibition will also likely be interpreted to apply to private funds sponsored or held by FHCs under the GLBA merchant banking rules in the FRB’s Regulation Y if they otherwise come within the scope of the definition of covered funds.
iii. Additional Prohibition on Covered Transactions

The Volcker Rule also prohibits a banking entity from entering into any transaction that would constitute a “covered transaction” under Section 23A of the FRA with a covered fund sponsored, managed, or advised by the banking entity. The Volcker Rule provides the FRB with authority to implement by rule a limited exception to this covered transaction prohibition for prime brokerage transactions.

Banking entities that sponsor, manage, or advise covered funds would also be subject to the “market terms” and other restrictions of Section 23B of the FRA in transactions entered into with those funds.

6. Exemptions from the Ban on Certain Relationships with Covered Funds

As with respect to the proprietary trading ban, the Dodd-Frank Act also includes several exemptions to the ban on investing in or sponsoring covered funds.

i. Fiduciary Exemption

The fiduciary exemption permits a banking entity to organize and offer a covered fund, including serving as a general partner or managing member, if all of the following eight conditions are satisfied:

- the banking entity provides investment advisory or other fiduciary services;
- the fund is organized in connection with those services and is offered only to customers of the banking entity;
- the banking entity does not have an equity interest in the fund, except for a de minimis investment (as described above);
- the banking entity does not enter into any covered transactions with the fund;
- the banking entity does not guarantee or insure the obligations or performance of a private fund;
- the banking entity does not share with the private fund the same name, or a variation thereof, for corporate, marketing, promotional, or other purposes;
- no director or employee of a banking entity has an interest in a private fund, except for any director or employee who is directly engaged in providing advisory services; and
- adequate disclosures are provided in the offering documents that the losses in a private fund are not borne by the banking entity.
**a. De Minimis Investment Authority**

The *de minimis* investment provision permits a banking entity to make investments in covered funds under the fiduciary exemption for purposes of either (i) establishing a fund and providing it with sufficient initial equity for investment to permit the fund to attract unaffiliated investors or (ii) making other *de minimis* investments. Whether the *de minimis* investment authority will also be available to funds that are not eligible for the fiduciary exemption appears unlikely.

A banking entity’s aggregate investment in all covered funds made pursuant to the *de minimis* investment authority must be “immaterial to the banking entity,” a term to be defined by rule, and in any case may not exceed three percent of Tier 1 capital of the banking entity. In the case of seed funding investments, a banking entity is permitted (subject to the aggregate investment limit of three percent of Tier 1 capital) to own any amount of a covered fund (up to 100 percent) at the time the fund is established. However, the banking entity must reduce its ownership interest in a covered fund within one year of the fund’s establishment (with the possibility of a two-year extension from the FRB) to not more than three percent of the total ownership interests of the fund. At this time, it is not clear whether a substantively non-ownership economic interest in a fund such as a carried interest would be included in the three percent calculations.

In addition, it is not clear how the *de minimis* exemption can be reconciled with the prohibition against any transaction between a banking entity (or affiliate) and any covered fund sponsored, managed, or advised by the banking entity that would be a covered transaction under section 23A of the FRA. A purchase of fund securities or ownership interests plainly would be a covered transaction for 23A purposes.

**ii. Offshore Exemption**

The offshore exemption applies to a banking entity’s investment in or sponsorship of a covered fund pursuant to Section 4(c)(9) or 4(c)(13) of the BHCA “solely outside of the United States.” This exemption parallels the offshore exemption contained in the proprietary trading provisions and raises similar interpretational issues with respect to non-US banks.
However, the offshore fund exemption also explicitly requires that no ownership interest in the fund be offered for sale or sold to a resident of the United States. Like the offshore exemption from the proprietary trading ban, this exemption also requires that the banking entity relying on the exemption not be owned or controlled directly or indirectly by a banking entity organized under US or state law.

iii. SBIC and “Public Welfare” Exemption

An additional exemption permits a banking entity to make investments in small business investment companies, certain investments that are “designed primarily to promote the public welfare,” and investments that are qualified rehabilitation expenditures related to a qualified rehabilitated building or certified historic structure. Because this exemption applies only to “investments,” it does not appear that it would exempt the sponsorship by a banking entity of otherwise covered funds.

iv. Agencies’ Authority to Establish Other Exemptions

The federal banking agencies, the SEC, and the CFTC may also exempt other activities that they determine “would promote and protect the safety and soundness of the banking entity and the financial stability of the United States.”

7. Exemption Limits

The exemptions from the Volcker Rule proprietary trading ban and private fund restrictions are not available if the exempt transaction or activity would:

- involve or result in a “material conflict of interest;”
- result in material exposures by the covered banking entity to “high-risk assets” or “high-risk trading strategies;”
- pose a threat to the safety and soundness of the banking entity; or
- pose a threat to the financial stability of the United States.

The definitions of material conflict of interest, high-risk assets, and high-risk trading strategies will be established by agency rulemaking. In particular, the manner in which a “material conflict of interest” is defined could have important implications for banking entities offering covered funds to their customers, where the presence of sponsor and management fees, among other things, can give rise to substantive conflicts of interest under federal or state law.
8. **Volcker Rule Applicability to Nonbank Financial Companies Supervised by the FRB**

Any nonbank firm that is engaged predominantly in financial activities, and which is designated as “systemically significant” under Title I of the Dodd-Frank Act, would be subject to heightened capital adequacy requirements and quantitative limits adopted by the FRB with respect to its proprietary trading and private fund activities. It is unclear how these limits would be applied in the case of designated non-US nonbanking firms such as insurance companies (which would be subject to designation if they have “substantial” US assets or operations), but based on the approach adopted in Title I with respect to such entities, the FRB is likely to look to whether there are comparable capital requirements in the home country. If such additional capital requirements have not been adopted in other countries, the FRB may have to decide whether to apply the higher requirements to a non-US company’s global capital or just to the US operations of the company. The Dodd-Frank Act does not specify any capital requirements or quantitative limits, leaving it to the FRB to determine these requirements through the rulemaking process.

9. **Implementation and Rulemaking**

Key deadlines for implementation of the Volcker Rule include the following:

i. **FSOC Study**

- The FSOC is required, within six months of enactment of the Dodd-Frank Act, to complete a study and make recommendations on implementing the provisions of the Volcker Rule so as to promote safety and soundness; protect taxpayers; limit the transfer of federal subsidies to unregulated entities; reduce conflicts of interest; limit activities that cause undue risk; appropriately accommodate the insurance business; and provide appropriate time for divestiture of illiquid assets affected by the rule. Language that had been included in the original Senate-passed bill that would have permitted the FSOC to recommend substantive modifications to the Volcker Rule, including the use of additional capital requirements or other limits in place of bans on certain activities, were not included in the Dodd-Frank Act.
ii. Rulemaking

- The federal banking agencies, the SEC, and the CFTC are required to consider findings of the study and adopt rules to carry out the Volcker Rule requirements within nine months after completion of the study.

iii. Effective Date

- The Volcker Rule prohibitions take effect on the earlier of 12 months after the date of issuance of final rules, or two years after the date of enactment of the Dodd-Frank Act.

iv. Conformance Period

- Banking entities and nonbank financial companies supervised by the FRB generally will have two years after the effective date to bring activities and investments into compliance with the Volcker Rule, although the FRB is permitted to extend that deadline by rule or order for up to three additional years in one year increments.

v. Extended Conformance Period for Illiquid Funds

- Upon application by a banking entity, the FRB may grant a further extension, not to exceed five years, during which time the banking entity may retain an equity, partnership, or other ownership interest in, or otherwise provide capital to, an “illiquid fund,” to the extent necessary to fulfill a contractual obligation. An illiquid fund for these purposes is a covered fund that as of May 1, 2010, was principally invested in, or contractually committed to invest principally in, illiquid assets pursuant to an investment strategy to invest in such assets.

C. Conflicts of Interest Related to Securitizations

Section 621 of the Dodd-Frank Act generally prohibits underwriters, placement agents, initial purchasers, and sponsors (including affiliates and subsidiaries) of an asset-backed security or synthetic asset-backed security from engaging, for one year from the closing date of the first sale, in any transaction that would involve or result in any “material conflict of interest” with respect to any investor in the security. This provision was added in conference largely in response to disclosures and allegations in the wake of the SEC’s recent regulatory activities (and related Congressional hearings) relating to collateralized debt obligations tied to the performance of subprime mortgage-backed securities. The SEC is required to issue regulations not later than 270 days after enactment to implement this provision.
The Dodd-Frank Act provides several exceptions to the general prohibition, including for certain risk-mitigating hedging activities, and for purchases or sales of asset-backed securities made pursuant to and consistent with (i) commitments to provide liquidity for the asset-backed security or (ii) bona fide market-making activities.

D. Nonbank Bank Moratorium and Study

For a period of three years following enactment, Section 603 of the Dodd-Frank Act:

- prohibits the FDIC from approving any application for deposit insurance filed after November 23, 2009, by an industrial bank, credit card bank, or trust bank directly or indirectly controlled by a commercial firm (i.e., a company that derives less than 15 percent of its consolidated annual gross revenues from banking and financial activities); and
- generally prohibits agency approval of any change in control application that would result in direct or indirect control of such a “nonbank bank” by a commercial firm.

Limited exceptions are provided for failing institutions, mergers or acquisitions at the parent commercial firm level, and acquisitions of less than 25 percent of publicly traded companies.

The GAO is required to complete a study within 18 months regarding the number, type, ownership, and adequacy of regulation of nonbank banks (including thrifts, which are not subject to the moratorium), including recommendations as to whether to eliminate the existing BHCA exceptions for nonbank banks and thrifts.

At the same time these provisions target the nonbank bank exceptions under the BHCA, other provisions of the Dodd-Frank Act expand the authority of credit card banks to offer small business loans (Section 628), and create a new exception from thrift holding company regulation for owners of thrifts that engage only in trust or fiduciary activities (Section 604(i)).

E. De Novo Interstate Branching

Section 613 of the Dodd-Frank Act expands the de novo interstate branching authority of national and state banks by eliminating the requirement that a state expressly “opt-in” to de novo branching. Instead, under the Dodd-Frank Act, the OCC and FDIC are authorized to approve applications for de novo interstate branches of national banks and state nonmember banks, respectively, if under the law of the state in which the branch is to be located, a state bank chartered by that state would be permitted to establish the branch. Because state member banks generally hold the same branching authority as national banks, the Dodd-Frank Act has the effect of authorizing de novo interstate branching by state member banks as well. It also permits de novo interstate branching by non-US banks, which under Section 5 of the IBA are permitted to branch outside of their “home”
states to the same extent that domestic banks may do so. These provisions take effect on the day after enactment.

F. Authorization of Interest-Bearing Transaction Accounts

Section 627 of the Dodd-Frank Act amends the FRA, HOLA, and FDIA to eliminate prohibitions against the payment of interest on demand deposits, essentially authorizing interest-bearing commercial checking accounts, and thus effectively repealing the FRB’s Regulation Q. This amendment is effective one year after enactment.

G. Concentration Limits

1. Ten Percent Consolidated Liabilities Cap

Section 622 of the Dodd-Frank Act imposes a new nationwide concentration limit on “financial companies,” which include insured depository institutions, bank and thrift holding companies, any other company that controls an insured depository institution, nonbank financial companies supervised by the FRB, and any non-US bank that has a US branch, agency, or bank subsidiary (or a company controlling such a non-US bank). Subject to several limited exceptions (and as may be modified by the FSOC study described below), financial companies are prohibited from merging, consolidating with, acquiring substantially all of the assets of, or otherwise acquiring control of another company if, upon consummation, the total consolidated liabilities of the resulting financial company would exceed ten percent of the aggregate consolidated liabilities of all financial companies.

The Dodd-Frank Act generally defines liabilities in this context as risk-weighted assets less regulatory capital, while authorizing the FRB to establish by rule a measure for insurance companies that provides “consistent and equitable treatment.” For non-US-based financial companies, liabilities will be determined on the basis of total risk-weighted assets of the US operations, as determined under applicable risk-based capital requirements, minus the regulatory capital of the US operations.

The FSOC is required to complete a study on the concentration limits within six months of enactment and the FRB is required to issue regulations implementing the prohibitions, subject to any recommendations by the FSOC, within nine months of the completion of the study. The FSOC study will consider how the concentration limit would affect financial stability; moral hazard in the financial system; the efficiency and competitiveness of US financial firms and markets; and the cost and availability of credit and other financial services to US households and businesses.
2. **Ten Percent Insured Deposit Cap**

Section 623 of the Dodd-Frank Act also revises the existing national deposit cap by expanding it to apply to all insured depository institutions rather than just to banks. Specifically, the Dodd-Frank Act prohibits the federal banking agencies from approving any interstate merger transaction or acquisition if the transaction would result in a bank or thrift holding company or the resulting depository institution (together with any affiliated insured institutions) controlling more than ten percent of all deposits in all insured depository institutions in the United States.

**H. Examination and Regulation of Bank and Thrift Holding Companies and Subsidiaries**

1. **Consideration of Risks to the US Financial System**

In an attempt to increase sensitivity to macroprudential concerns, Section 604 of the Dodd-Frank Act makes explicit that the FRB’s examination authority over bank and thrift holding companies and their subsidiaries is intended to inform the FRB about risks not only to a particular holding company and its depository institution subsidiaries but also to the stability of the US financial system. Similarly, the Dodd-Frank Act requires the FRB to consider the extent to which applications for bank acquisitions under Section 3 of the BHCA and for nonbank acquisitions under Section 4 of the BHCA would result in greater or more concentrated risks to the stability of the US financial system. Each bank regulatory agency also is required to consider risks to the stability of the US banking and financial system in evaluating bank merger applications.

2. **Enhanced FRB Regulation of Nonbank Subsidiaries**

Section 605 of the Dodd-Frank Act adds a new Section 26 to the FDIA requiring the FRB to examine and regulate the activities of a bank or thrift holding company’s non-depository institution subsidiaries (excluding functionally regulated subsidiaries) that are permissible for depository institutions in the same manner, subject to the same standards, and with the same frequency as would be required if those activities were conducted in an insured depository institution. The Dodd-Frank Act requires coordination with state authorities where the non-depository institution subsidiary is regulated by the state, as well as for “back-up” examination and enforcement authority over those subsidiaries by the federal regulator of the holding company’s lead depository institution.
Section 604 of the Dodd-Frank Act enhances the authority of the FRB to examine functionally regulated subsidiaries and broadly scales back restrictions on the FRB’s authority with respect to such subsidiaries. However, a provision included in the original Senate-passed bill that would have permitted the FRB to impose capital requirements on functionally regulated subsidiaries was eliminated by the Conference Committee and was not included in the Dodd-Frank Act.

3. Additional Restrictions on Financial Holding Companies

Section 606 of the Dodd-Frank Act requires that FHCs themselves be well capitalized and well managed in order to engage in, or acquire any company engaged in, activities not permissible for a BHC under Section 4(c)(8) of the BHCA. Under prior law, this requirement applied only to an FHC’s depository institution subsidiaries. This change will make the standards for US FHCs more comparable to those for non-US FHCs that maintain US branches and agencies, which under the FRB’s Regulation Y are required to be well capitalized and well managed at the non-US bank level. However, the change could also be interpreted by the FRB to apply to the parent company of a non-US bank.

In addition, Section 604 of the Dodd-Frank Act imposes a new requirement that financial holding companies obtain prior approval of the FRB before acquiring a company engaged solely in financial activities if the assets of the acquired company exceed $10 billion. Notwithstanding this requirement, the Dodd-Frank Act appears to treat such acquisitions as if FRB approval were not required for purposes of the Hart-Scott-Rodino Act, which means that a Hart-Scott-Rodino filing would still be required.

4. Enhanced Standards for Interstate Bank Acquisitions

Section 607 of the Dodd-Frank Act requires that a BHC be well capitalized and well managed (rather than simply adequately capitalized and adequately managed as required under prior law) in order to engage in an interstate bank acquisition. The Dodd-Frank Act similarly prohibits the federal banking agencies from approving an interstate bank merger unless the resulting bank will be well capitalized and well managed.

I. Source of Strength

Section 616 of the Dodd-Frank Act codifies and expands the FRB’s source of strength doctrine, mandating the FRB to require bank and thrift holding companies to provide “financial assistance” to their insured depository institution subsidiaries if those subsidiaries are in “financial distress.” Moreover, the appropriate federal banking agency for any insured depository institution that is not the subsidiary of a bank or thrift holding
company is vested with similar authority with respect to any company that directly or indirectly controls the depository institution (controlling persons who are not “companies” are excluded from this requirement). The agencies are required within one year of the Title III transfer date (which is one year after enactment unless extended by Treasury) to issue joint final rules to carry out the source of strength provisions, although the statutory source of strength requirement itself takes effect on the transfer date. It is unclear, however, whether these requirements can or will create an enforceable creditor claim against a bankrupt financial company under the US Bankruptcy Code.

J. Lending Limits and Insider Transactions

1. Exposure to Derivatives, Repos, Reverse Repos, and Securities Lending

Effective one year after the Title III transfer date, Section 610 of the Dodd-Frank Act makes any credit exposure arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction, a “loan or extension of credit” subject to the national bank lending limits and insider lending limits that apply to all insured banks and thrifts. Because branches and agencies of non-US banks are generally subject to the same lending limits as national banks, this change will impact their lending authority as well.

In a parallel but potentially far-reaching provision, Section 611 of the Dodd-Frank Act permits an insured state bank to engage in derivative transactions only if its chartering state’s lending limits law “takes into consideration” credit exposures from derivative transactions. This last provision relating to state banks takes effect 18 months after the Title III transfer date (or at least two and half years after enactment), presumably to give states ample time to amend their lending limits.

2. Asset Purchases from Insiders and Asset Sales to Insiders

Section 615 of the Dodd-Frank Act generally prohibits an insured depository institution from purchasing an asset from, or selling an asset to, any executive officer, director, or principal shareholder, or any of their related interests, unless the transaction (i) is on market terms, and (ii) if the transaction exceeds ten percent of the institution’s capital and surplus, is approved in advance by a majority of disinterested board members.
K. Affiliate Transaction Restrictions

Effective one year after the Title III transfer date, Sections 608 and 609 of the Dodd-Frank Act amend Sections 23A and 23B of the FRA to expand the reach of the affiliate transaction restrictions and scale back the authority of the FRB to issue Section 23A and 23B exemptions. Specifically, the Dodd-Frank Act:

- makes any investment fund for which a bank or its affiliate serves as an investment adviser an affiliate of the bank for Section 23A purposes—not just funds registered under the ICA or funds in which the bank or its affiliate owns more than five percent, as is the case under the FRB’s current Section 23A regulations;
- amends the definition of “covered transaction” to include (i) securities borrowing or lending transactions with an affiliate, and (ii) all derivatives transactions with an affiliate (not just credit derivatives, which are the only derivatives transactions currently subject to Section 23A), to the extent that either causes a bank or its affiliate to have credit exposure to the securities borrowing/lending or derivative counterparty;
- subjects repurchase agreements to the collateral requirements of Section 23A;
- expressly requires that credit transactions subject to the Section 23A collateral requirements be collateralized at all times, rather than just at the time the transaction is entered into;
- eliminates the exception from the quantitative limits of Section 23A previously afforded to transactions between a bank and its financial subsidiary; and
- replaces the FRB’s unilateral authority to issue exemptions from Sections 23A and 23B, with a formal requirement for the FRB to act jointly with the primary regulator of the bank and the FDIC.

These changes will also apply to US branches and agencies of non-US banks to the extent that an affiliate is subject to affiliate transaction restrictions under the FRB’s Regulation W. The Dodd-Frank Act also permits the FRB to issue regulations or interpretations regarding the manner in which netting agreements should be taken into account in determining the amount of a covered transaction. An interpretation with respect to a specific bank must be issued jointly with the bank’s primary regulator.

L. Restrictions on Conversions of Troubled Institutions

Section 612 of the Dodd-Frank Act prohibits the conversion of a national bank to a state bank or thrift charter, or a state bank or thrift to a national bank or thrift charter, during any period when the bank or thrift is subject to a cease and desist order (or other formal enforcement order) or memorandum of understanding concerning “a significant supervisory matter.” A similar provision prohibits the conversion of a troubled federal thrift to a state bank or thrift charter. Although earlier versions of the bill would have left this as a flat prohibition on conversions, the Conference Committee added additional provisions that permit the conversion if a plan is developed by the new regulator to
address the deficiencies, and the regulator that issued the order or memorandum of understanding does not object. The Dodd-Frank Act thus codifies and strengthens in certain respects the existing policy statement on conversions adopted in July 2009 by the federal banking regulators.

M. **Grandfathered Unitary Thrift Holding Companies**

Section 626 of the Dodd-Frank Act authorizes the FRB to require that any financial activities conducted by a grandfathered unitary thrift holding company (generally, commercial firms that have controlled a single thrift since May 4, 1999) be conducted through a newly established intermediate holding company that will be subject to FRB regulation as a thrift holding company. The FRB must adopt regulations establishing the criteria for determining when such intermediate thrift holding companies must be established.

Any grandfathered unitary holding company parent of an intermediate thrift holding company would have to act as a “source of strength” to the intermediate holding company, provide limited reports to the FRB, be subject to limited enforcement actions by the FRB, and comply with any FRB regulations applying affiliate transaction limitations to transactions between the parent and intermediate holding company. However, the grandfathered unitary holding company would not otherwise be subject to FRB or BHCA regulation, including with respect to restrictions on its commercial activities.

The Dodd-Frank Act generally permits a grandfathered unitary thrift holding company to continue to engage in “internal financial activities” without establishing an intermediate holding company, provided that the activities do not present an undue risk to the grandfathered unitary thrift or to the financial stability of the United States, and subject to certain quantitative requirements.

N. **Supervision of Securities Holding Companies**

Section 618 of the Dodd-Frank Act formally eliminates the statutory elective investment bank holding company framework administered but recently abandoned by the SEC. It is replaced by a new framework for the supervision and regulation of “securities holding companies,” which are companies that own or control one or more SEC-registered broker-dealers and are not otherwise subject to comprehensive consolidated supervision in the United States (e.g., because they do not own a US bank and have not been designated as “systemically important” under Title I of the Dodd-Frank Act) or abroad. As a result, a securities holding company required by non-US law or regulation to be subject to comprehensive consolidated supervision may register with the FRB and become a “supervised securities holding company” subject to such regulation by, among other things:
• satisfying FRB recordkeeping and reporting requirements;
• submitting to FRB supervision and examination;
• meeting capital adequacy and other risk management standards established for such companies by the FRB; and
• complying with the BHCA (other than the nonbanking prohibitions) in the same manner and to the same extent as a BHC.

O. Miscellaneous

1. Study of Bank Investment Activities

Section 620 of the Dodd-Frank Act requires the federal banking agencies, within 18 months, to undertake a comprehensive study on the activities and investments permissible for “banking entities” as defined in the context of the Volcker Rule (discussed above), and prepare a report, with recommendations, regarding the potential impact of those activities and investments on safety and soundness or financial stability; the appropriateness of those activities and investments for banking entities; and additional restrictions that may be necessary.

2. Countercyclical Capital Requirements

Section 616 of the Dodd-Frank Act codifies FRB authority to issue regulations and orders relating to capital requirements for BHCs, extends that authority to thrift holding companies, and directs the FRB (as well as the other federal banking agencies) to attempt to make regulatory capital requirements countercyclical (i.e., by requiring increased capital in times of economic expansion and permitting reduced capital during economic contraction).

3. Dividend Restrictions for Non-Qualified Thrift Lenders

Section 624 of the Dodd-Frank Act imposes additional restrictions on the ability of any thrift that fails to become or remain a qualified thrift lender to pay dividends. Specifically, the thrift is not only subject to the general dividend restrictions as would apply to a national bank (as under prior law), but also is prohibited from paying dividends at all (regardless of its financial condition) unless required to meet the obligations of a company that controls the thrift and specifically approved by the OCC and FRB. In addition, violations of the QTL test now are treated as violations of HOLA subject to remedial enforcement action.
A. Summary

Title VII of the Dodd-Frank Act, the “Wall Street Transparency and Accountability Act,” will provide extensive authority to the CFTC and the SEC to regulate the OTC derivative markets. Under the new regulatory regime, swap dealers and major swap participants would, subject to certain exceptions, be required to clear swaps through a clearinghouse, and to execute their transactions on a centralized exchange. Market participants will be subject to capital and margin requirements, position limits, business conduct rules and post-trade transparency requirements. One of the more controversial provisions in Title VII is the prohibition on federal assistance to swaps entities (with certain exceptions for insured depository institutions). These changes promise to alter fundamentally the landscape in which market participants conduct their business in the OTC derivative markets.

Pursuant to Sections 754 and 774, unless otherwise provided in Title VII, the provisions of Title VII shall take effect on the later of 360 days after the date of the enactment of Title VII or, to the extent a provision requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision.

B. Push Out of Swap Activities

Under Section 716, no “federal assistance” may be provided to any “swaps entity.” Federal assistance is defined as the “use” of most kinds of advances from any Federal Reserve credit facility or discount window, or FDIC insurance or guarantee. A swaps entity includes any swap dealer, security-based swap dealer, major swap participant or major security-based swap participant. US banks and US branches and agencies of foreign banks are eligible for various kinds of federal assistance set forth in Section 716.

Banking institutions that are required to register as swap dealers or major swap participants by virtue of their swap activities (as discussed below) would lose their eligibility for federal assistance. Since an insured bank is not permitted to decline federal deposit insurance, this would mean, as a practical matter, that, unless otherwise exempt, banks will be required to “push out” all derivatives activities, including hedging, market making, and other intermediary activities, to separate nonbank affiliates that do not enjoy access to federal assistance. Section 716 explicitly permits bank holding companies and thrift holding companies to have such nonbank swap entities, which are otherwise
permissible under law, subject to affiliate transaction restrictions under Sections 23A and 23B of the FRA with respect to transactions with the affiliated bank.

In a last minute compromise in conference, an exemption was added for FDIC-insured depository institutions to mitigate the impact of the push out. Such institutions would not be forced to push out the following kinds of swap activities:

- hedging the depository institution’s risk;
- engaging in any kind of swap transaction involving rates or reference assets permitted as national bank investments under the NBA, such as interest rate swaps and currency swaps; and
- CDSs that are cleared by a clearinghouse.

Such depository institutions would be required to push out other kinds of swaps that are based on reference assets that banks may not invest in, such as most commodities and equity securities, as well as uncleared CDS, unless they enter into these transactions for hedging purposes.

In an apparent oversight, this exemption was not made available to uninsured branches and agencies of foreign banks that have access to the discount window, but that are not eligible for FDIC insurance. Under the longstanding US policy of national treatment, as well as other policy considerations, such branches and agencies should have the same exemptions. As with many other unintended issues raised by the final language of the Dodd-Frank Act, it is expected that this discrepancy will be corrected by legislative amendment or interpretation, before the swaps push out becomes effective.

The effective date for this provision is two years after the general effective date of the Dodd-Frank Act, which, according to Section 4, is one day after enactment. There is also a two-year transition period for insured depository institutions to comply with this section, with the possibility of a one year extension. While the statutory language is not entirely clear, it appears that this transition period will begin after the effective date. The prohibitions will only apply to swaps entered into after the transition period.

C. Definition of “Swap”

Section 721 defines a “swap” as any agreement, contract, or transaction that is an option for the purchase or sale, or is based on the value, of an underlying financial or economic interest or property, or that provides for any purchase, sale, payment, or delivery that is dependent on the occurrence, non-occurrence, or the extent of the occurrence of an event associated with a potential financial, economic, or commercial consequence. Among the products included in the definition of “swap” are interest rate swaps, foreign exchange swaps, credit default swaps, equity swaps, energy swaps and commodity swaps. A security-based swap is defined in Section 761 as any agreement, contract, or transaction that is a swap and is based on a narrow-based security index, a single security
or loan, or the occurrence, non-occurrence, or the extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer. Mixed swaps will be regulated by the SEC as security-based swaps. Mixed swaps include security-based swaps that are also based on the value of one or more financial or economic interests or property, or the occurrence, non-occurrence, or the extent of the occurrence of any event or contingency associated with a potential financial, economic, or commercial consequence.

Among the exclusions from the definition of “swap” are sales of non-financial commodities for deferred shipment or delivery, so long as the transaction is intended to be physically settled. Section 721 provides that foreign exchange swaps and foreign exchange forwards are considered swaps, unless the Secretary makes a determination that either or both products should not be regulated as swaps under the Dodd-Frank Act, and are not structured to evade the Dodd-Frank Act in violation of any rule promulgated by the CFTC pursuant to the Dodd-Frank Act (although, in such circumstances, they would still have to be reported to a repository, and they would still be subject to the business conduct standards discussed below). Notwithstanding any such determination, foreign exchange swaps and foreign exchange forwards would be regulated as swaps, if they are cleared by any clearinghouse or traded on any exchange or swap execution facility.

Section 722 provides that swaps will not be considered insurance and will not be regulated as insurance under state law.

D. Regulatory Coordination

Section 712 requires the CFTC and the SEC to consult with each other and with the “prudential regulators” (i.e., the federal banking regulators of banking institutions engaged in swap activities) in developing regulations and orders applicable to swaps, swap dealers, major swap participants and other swap entities to the extent possible to ensure regulatory consistency. Moreover, any interpretation of any matter requiring joint regulation must also be approved by both the CFTC and the SEC in consultation with the FRB. The FSOC is authorized to resolve disputes between the CFTC and the SEC.

Section 720 requires the CFTC and the Federal Energy Regulatory Commission to enter into an MOU within 180 days of enactment to avoid conflicting regulation, and to resolve conflicts of overlapping jurisdiction. They must also negotiate an MOU to share information relating to investigations. Within 180 days of enactment, an interagency group shall conduct a study on the oversight of existing and prospective carbon markets to ensure an efficient, secure, and transparent carbon market, including oversight of spot markets and derivative markets.
E. Regulation of Swap Markets

Under the new regulatory regime, registered swap dealers and major swap participants will be required to comply with clearing and execution requirements, as well as reporting, recordkeeping, and capital and margin rules. The description below applies equally to swaps and security-based swaps, to swap dealers and security-based swap dealers, and to major swap participants, and major security-based swap participants. The CFTC will have jurisdiction over swaps, swap dealers and major swap participants. The SEC will have jurisdiction over security-based swaps, security-based swap dealers, and major security-based swap participants. As used herein, the term “Applicable Agency” refers to the CFTC (with respect to swaps, swap dealers and major swap participants) and to the SEC (with respect to security-based swaps, security-based swap dealers, and major security-based swap participants).

1. Clearing

Sections 723 and 762 provide, in the event that a swap is required to be cleared, that it shall be unlawful for any person to engage in such swap without submitting it for clearing. The Applicable Agency, on an ongoing basis, will review each swap, or any group, category, type, or class of swaps, to make a determination as to whether the swap or group, category, type, or class of swaps should be required to be cleared. The Applicable Agency shall provide at least a 30-day public comment period regarding any such determination. Further, a clearinghouse shall submit to the Applicable Agency each swap, or group, category, type, or class of swaps, that it plans to accept for clearing, and provide notice to its members of such submission. In addition, any swap, group, category, type or class of swaps listed for clearing by a clearinghouse as of the enactment date shall be considered to have been already submitted for review to the Applicable Agency.

The Applicable Agency shall make available to the public any submissions that it receives from clearinghouses, shall determine whether the swap, or group, category, type, or class of swaps, described in the submission is required to be cleared, and provide at least a 30-day public comment period regarding its determination as to whether the clearing requirement applies. In reviewing a submission, the Applicable Agency will review whether the submission is consistent with the core principles of the relevant derivative clearing organization (for swaps) or clearing agency (for security-based swaps), as applicable. The Applicable Agency shall also take into account the following factors in its reviews:

- the existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data
- the availability of a rule framework, capacity, operational expertise, and resources, and credit support infrastructure to clear the contract on terms
that are consistent with the material terms and trading conventions on which the contract is then traded

- the effect on the mitigation of systemic risk, taking into account the size of the market for such contract, and the resources of the clearinghouse available to clear the contract
- the effect on competition, including appropriate fees and charges applied to clearing
- the existence of reasonable legal certainty in the event of the insolvency of the relevant clearinghouse, or one or more of its clearing members, with regard to the treatment of customer and swap counterparty positions, funds, and property

The clearing requirement will not apply to a swap if one of the counterparties to the swap is not a financial entity (defined as a swap dealer, a major swap participant, or other category of financial institution), is using the swap to hedge or mitigate commercial risk, and notifies the Applicable Agency how it generally meets its financial obligations associated with entering into non-cleared swaps. This has been termed the “commercial end user exemption.” In such circumstances, the counterparty that satisfies the criteria for the exemption will still retain the option to clear, in its sole discretion, and will have the option to choose the clearinghouse.

Clearing transition rules provide that swaps entered into before the date of enactment shall be reported to a repository, or the Applicable Agency, no later than 180 days after the effective date of Title VII (i.e. 360 days after enactment), and that swaps entered into before application of the clearing requirement are exempt from the clearing requirements, if reported to a repository or the Applicable Agency not later than the later of 90 days after the effective date of Title VII, or at such other time as the Applicable Agency may prescribe.

2. **Execution**

Sections 723 and 762 provide that all swaps that are subject to the clearing requirement must be traded on a regulated exchange or on a swap execution facility. A swap execution facility is a facility trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system. The execution requirement will not apply if no board of trade or swap execution facility makes the swap available to trade. It will also not apply in the case of swaps that are not cleared because one of the counterparties satisfies the commercial end user exemption.
3. Registration and Regulation of Swap Dealers and Major Swap Participants

i. Swap Dealers and Major Swap Participants

A swap dealer is any person who (i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps. In no event shall an insured depository institution be considered to be a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer. A person may be designated as a swap dealer for a single type or single class or category of swap or activity, and considered not to be a swap dealer for other types, classes, or categories of swaps or activities. The term “swap dealer” does not include a person that enters into swaps for such person’s own account, either individually or in a fiduciary capacity, but not as a part of a regular business. The Applicable Agency shall exempt from designation as a swap dealer any entity that engages in a de minimis quantity of swap dealing in connection with transactions with or on behalf of customers.

A major swap participant is any person who is not a swap dealer and (i) maintains a substantial position in swaps for any of the major swap categories as determined by the Applicable Agency, excluding positions held for hedging or mitigating commercial risk (or in the case of certain pension plans, plan risk); (ii) whose outstanding swaps create substantial counterparty exposure that could have serious adverse effect on the financial stability of the US banking system or financial markets; or (iii) is a financial entity that is highly leveraged relative to the amount of capital that it holds and that is not subject to capital requirements established by an appropriate federal banking agency and maintains a substantial position in outstanding swaps in any major swap category as determined by the Applicable Agency. A person may be designated as a major swap participant for one or more categories of swaps without being classified as a major swap participant for all classes of swaps. The definition of “substantial position” is left to the Applicable Agencies at the threshold that they determine is prudent for oversight of entities that are systemically important. An entity whose primary business is financing a parent entity’s products, and that hedges related interest rate and currency risk, may be excluded.
ii. Registration

Section 731 provides that it shall be unlawful for any person to act as a swap dealer or a major swap participant unless the person is registered as a swap dealer or as a major swap participant with the Applicable Agency. Any person that is required to be registered as a swap dealer or a major swap participant with the CFTC shall be required to register with the CFTC, regardless of whether such person also is a depository institution, or is registered with the SEC as a security-based swap dealer or a major security-based swap participant. Section 764 includes an equivalent provision for security-based swap dealers and major security-based swap participants to register with the SEC, regardless of whether they are already registered with the CFTC. Rules shall provide for the registration of swap dealers and major swap participants not later than one year after the date of enactment of the Dodd-Frank Act.

iii. Regulation

Sections 731 and 764 provide that, for swap dealers and major swap participants that are banks, the prudential regulators, in consultation with the Applicable Agencies, will jointly adopt rules with respect to their activities as swap dealers or major swap participants, imposing capital requirements, and initial and variation margin requirements, on all swaps that are not cleared. For swap dealers and major swap participants that are not banks, the Applicable Agency shall adopt such rules.

iv. Recordkeeping and Reporting

Sections 731 and 764 require that all registered swap dealers and major swap participants, including banks, maintain daily trading records of swaps and all related records (including related cash or forward transactions) and recorded communications, including electronic mail, instant messages, and recordings of telephone calls, for such period as may be required by the Applicable Agency, by rule or regulation. Each registered swap dealer and major swap participant shall also be required to maintain a complete audit trail for conducting comprehensive and accurate trade reconstructions.

Sections 727 and 763 authorize the Applicable Agency to make swap transaction and pricing data available to the public in such form and at such times as are deemed appropriate to enhance price discovery. Real-time public reporting will be required with respect to those swaps and security-based swaps that are subject to mandatory clearing (including
those subject to the commercial end user exemption), and also with respect to those swaps and security-based swaps that are not subject to the mandatory clearing requirement but are cleared. With respect to any uncleared swaps and security-based swaps that are reported to a repository, real-time public reporting will be required in a manner that does not disclose the business transactions and market positions of any person. “Real-time public reporting” means to report data relating to a transaction, including price and volume, as soon as technologically practicable after execution of the transaction.

v. Rulemaking on Conflict of Interest

Sections 726 and 765 require, not later than 180 days after enactment of the Dodd-Frank Act, that the Applicable Agency adopt rules it determines are necessary or appropriate to improve the governance of, or to mitigate systemic risk, promote competition, or mitigate conflicts of interest in connection with a swap dealer or major swap participant’s conduct of business with a derivatives clearing organization, clearing agency, contact market, national securities exchange or swap execution facility that clears, posts, or makes swaps available for trading and in which such swap dealer or major swap participant has a material debt or equity interest. Such rules may include numerical limits on the control of, or the voting rights with respect to, any such entity by a BHC with total consolidated assets of $50 billion or more, a nonbank financial company supervised by the FRB, swap dealer, major swap participant, or any affiliate or associated person thereof.

4. Capital and Margin Requirements

Sections 731 and 764 require that the federal banking regulators for swap dealers and major swap participants that are banks, and the Applicable Agency for swap dealers and major swap participants that are not banks, set minimum capital requirements and minimum initial and variation margin requirements. The use of noncash collateral is to be permitted, as the regulator or the Applicable Agency determines to be consistent with “preserving the financial integrity of markets trading swaps” and “preserving the stability of the United States financial system.”

The banking regulators, the CFTC, and the SEC are to consult at least once a year on such minimum requirements and, to the maximum extent possible, set and maintain such requirements at comparable levels.

Section 724 requires that margin for swaps cleared on a CFTC-regulated clearinghouse may be held only by CFTC-registered FCMs. FCMs must segregate
all money, securities, and property of any swaps customer received as margin and cannot commingle such with its own funds or use it to margin, secure, or guarantee any trades or contracts with other swaps customers or persons, although it can be commingled and deposited in the same account or accounts with any bank or trust company or with a derivatives clearing organization. Any such funds that are held by FCMs may be invested in certain governmental obligations, obligations fully guaranteed by the United States, and other approved investments.

For non-cleared swaps, swap dealers and major swap participants must notify counterparties of their right to require segregation of the funds or other property held as margin in a segregated account carried by an independent third-party custodian and for and on behalf of the counterparty. This requirement does not apply to variation margin payments and does not preclude any commercial arrangements regarding investment of such funds or other property that may only be invested in CFTC-approved investments and/or the allocation of gains and losses resulting from investment of the segregated funds or other property.

Unlike the treatment of the clearing requirements, there are no provisions in the Dodd-Frank Act exempting or excepting from capital and margin requirements any swaps entered into prior to the effective and/or enactment dates under the Dodd-Frank Act. However, Senators Dodd and Lincoln (Chairmen of the Senate Committee on Banking, Housing, and Urban Affairs and the Senate Committee on Agriculture, Nutrition, and Forestry, respectively) sent a letter to Representatives Frank and Peterson (Chairmen of the House Financial Services Committee and the House Committee on Agriculture, respectively) on June 30, 2010, stating that it is Congress’ intent that margin and capital requirements are not to be imposed on commercial end-users; regulators may not impose rules that require margin on the commercial end-user side of a transaction; and, for uncleared swaps with a commercial end-user, margin on the dealer side of the transaction should reflect the counterparty risk of the transaction.

5. **Position Limits**

Section 737 requires, for swaps that perform or affect a significant price discovery function with respect to registered entities, that the CFTC establish limits on the number of positions, other than *bona fide* hedge positions, that may be held by any person for the spot month, and for each other month, as well as on the aggregate number of positions that may be held by any person, including any group or class of traders. The swap execution facilities are to establish for each of the swaps of the facility position limits, such limits to be no higher than those established by the CFTC. Section 737, and the amendments made by it, will become effective on the date of enactment of the Dodd-Frank Act.
Section 739 provides that any position limit established under the Dodd-Frank Act will not apply to a position acquired in good faith before the effective date of any rule, regulation, or order under the Dodd-Frank Act that establishes the position limit, unless such position is increased after the effective date. Section 737 provides that the CFTC may also exempt, conditionally or unconditionally, any person or class of persons, any swap or class of swaps, or any transaction or class of transactions, from any requirement it may establish with respect to position limits. Within 12 months of the imposition of position limits, the CFTC must deliver to Congress a study on any effects of position limits in moving transactions from US exchanges to non-US venues.

Section 763 provides that the SEC shall, by rule or regulation, as necessary or appropriate in the public interest or for the protection of investors, establish limits (including related hedge exemption provisions) on the size of positions in any security-based swap that may be held by any person. Section 763 also provides that the SEC may exempt conditionally or unconditionally, any person or class of persons, any security-based swap or class of security-based swaps, or any transaction or class of transactions, from any requirement it may establish with respect to position limits.

6. Business Conduct Rules

Sections 731 and 764 require each registered swap dealer and major swap participant to comply with business conduct standards to be adopted by the Applicable Agency, which shall:

- establish a duty for a swap dealer or major swap participant to verify that any counterparty meets the eligibility standards for an eligible contract participant
- require disclosure by the swap dealer or major swap participant to any counterparty to the transaction (other than a swap dealer or major swap participant) of information about the material risks and characteristics of the swap, any material incentives, or conflicts of interest that the swap dealer or major swap participant may have in connection with the swap, and the daily mark of the transaction
- establish a duty for a swap dealer or major swap participant to communicate in a fair and balanced manner based on principles of fair dealing and good faith
- establish such other standards and requirements as the Applicable Agency may determine are appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Dodd-Frank Act

Swap dealers and major swap participants will have additional responsibilities with respect to “special entities.” Special entities include federal agencies, states,
state agencies and other political subdivisions of a state, certain pension plans, and endowments. Any swap dealer or major swap participant that offers to enter or enters into a swap with a special entity shall comply with any duty established by the Applicable Agency that requires the swap dealer or major swap participant to have a reasonable basis to believe that the counterparty that is a special entity has an independent representative that:

- has sufficient knowledge to evaluate the transaction and risks;
- is not subject to a statutory disqualification;
- is independent of the swap dealer or major swap participant;
- undertakes a duty to act in the best interests of the counterparty it represents;
- makes appropriate disclosures;
- will provide written representations to the special entity regarding fair pricing and the appropriateness of the transaction; and
- is a fiduciary in the case of employee benefit plans subject to ERISA.

A swap dealer will also be required to disclose in writing the capacity in which it is acting to the special entity before the initiation of the transaction. Any swap dealer that acts as an adviser to a special entity shall have a duty to act in the best interests of the special entity and shall be required to use reasonable efforts to obtain such information as is necessary to make a reasonable determination that any swap recommended by the swap dealer is in the best interests of the special entity.

The business conduct requirements shall not apply with respect to a transaction that is initiated by a special entity on an exchange or swap execution facility and to transactions in which the swap dealer or major swap participant does not know the identity of its counterparty. The business conduct requirements in the Dodd-Frank Act, as they relate to special entities, are less strict than in the original Senate-passed bill, which provided that a swap dealer that provides advice regarding, or offers to enter into, or enters into a swap with a special entity, would have a fiduciary duty to that special entity. The Senate version would have raised serious issues for swap dealers and may have had the practical effect of making swaps unavailable to the special entities.

7. Regulation of Swap Execution Facilities, Clearinghouses, and Repositories

i. Swap Execution Facilities

Sections 733 and 763 provide that no person may operate a facility for the trading or processing of swaps, unless the facility is registered as a
swap execution facility or as a designated contract market. To be registered, and maintain registration, as a swap execution facility, the swap execution facility must comply with the requirements and core principles specified in the Dodd-Frank Act, as well as any additional requirements imposed by the Applicable Agency. The core principles include requirements as to:

- the swap execution facility only permitting trading in swaps that are not readily susceptible to manipulation
- monitoring of trading and trade processing
- obtaining and disclosing information
- adoption of appropriate position limitations and position accountability for speculators
- establishment and enforcement of rules and procedures to ensure the financial integrity of transactions
- recordkeeping
- antitrust considerations
- conflicts of interest
- corporate governance
- system safeguards

ii. Clearinghouses

Section 725 provides that a depository institution or clearing agency registered with the SEC that is required to be registered as a derivatives clearing organization with the CFTC is deemed to be registered with the CFTC to the extent that, before enactment of the Dodd-Frank Act, the depository institution cleared swaps as a multilateral clearing organization or the clearing agency cleared swaps. The CFTC may exempt, conditionally or unconditionally, a derivatives clearing organization from registration if the CFTC determines that the derivatives clearing organization is subject to comparable, comprehensive supervision and regulation by the SEC or the appropriate government authorities in the home country of the organization. To be registered, and maintain registration, as a derivatives clearing organization, the derivatives clearing organization must comply with the requirements and core principles specified in the Dodd-Frank Act, as well as any additional requirements imposed by the CFTC. The core principles include requirements as to:

- financial resources
- establishment of admission and eligibility standards for participants and products
iii. Repositories

Sections 727 and 763 provide that each swap (whether cleared or uncleared) shall be reported to a registered swap data repository. A swap data repository is any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for swaps. Sections 728 and 763 provide that, to be registered, and maintain registration, as a swap data repository, the swap data repository must comply with the requirements and core principles specified in the Dodd-Frank Act (which include requirements as to governance, conflicts of interest, and antitrust), as well as any additional requirements imposed by the Applicable Agency. The standards imposed by the Applicable Agency with respect to swap data repositories will be comparable to those imposed on clearinghouses. The reporting provisions of Sections 727 and 763 shall be effective upon enactment of the Dodd-Frank Act. The Applicable Agency shall be required to promulgate an interim final rule within 90 days of enactment of the Dodd-Frank Act, providing for the reporting of each swap entered into before the date of enactment of the Dodd-Frank Act. Each swap entered into before the date of enactment of the Dodd-Frank Act, the terms of which have not expired as of the date of enactment, shall be reported to a repository or the Applicable Agency, by a date that is not later than 30 days after issuance of the interim final rule or in such other period as the Applicable Agency determines to be appropriate.

8. International Harmonization and Extraterritorial Issues

The new US regulation of derivatives may create differences with regulatory schemes in other parts of the world. In addition, cross-border derivatives
transactions are common. These circumstances raise issues of whether standards can be harmonized and impact potential extraterritorial effects if they are not.

Under the Dodd-Frank Act, there may be extraterritorial impacts on entities located outside the United States that enter into transactions with US counterparties or otherwise use US jurisdictional means. Thus, cross-border transactions may subject entities outside of the United States to the new US registration and regulatory requirements.

In this regard, Sections 722 and 772 of the Dodd-Frank Act provide that the Dodd-Frank Act shall not apply to activities outside the United States, unless those activities have a direct and significant connection with activities in, or effect on, commerce of the United States, or contravene such regulations as the Applicable Agency may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of the Dodd-Frank Act. These provisions provide a basis for the Applicable Agencies to reduce the potential extraterritorial impact of the US regulatory scheme on non-US swap dealers and major swap participants.

Section 752 requires the Applicable Agencies to consult with foreign regulators on the establishment of consistent international standards and permits them to share information with foreign regulators. These consultations may also provide a basis for exemptions for entities in other jurisdictions that are subject to a comparable regulatory scheme from having to register with the Applicable Agency because of transactions with US counterparties or use of US jurisdictional means.

Section 715 permits the Applicable Agency, in consultation with the Treasury, to prohibit a company resident in a foreign country from participating in the United States in swap activities if the Applicable Agency determines that the regulation of swaps in the foreign country undermines the stability of the US financial system. Accordingly, if swap participants move to jurisdictions with lax regulation, the United States may use this authority to prohibit entities from that jurisdiction from doing any swap business in the United States.

Section 719 of the Dodd-Frank Act requires the Applicable Agencies to perform a study of regulation of swaps in other countries within 18 months of the enactment of the Dodd-Frank Act that identifies areas of regulation that may be harmonized.
F. Regulation of Security-Based Swap Markets

1. Amendments to Federal Securities Laws

i. Securities Exchange Act of 1934

Most of the amendments to the Exchange Act represent conforming changes to those made by the legislation to the Commodity Exchange Act. Pursuant to Section 762, security-based swaps are now considered to be “securities” for purposes of the Exchange Act. In addition, Section 766 amends the beneficial ownership provisions of Section 13 of the Exchange Act to include beneficial ownership of securities upon the purchase or sale of a security-based swap. For purposes of Section 13 and Section 16 of the Exchange Act, a person shall be deemed to acquire beneficial ownership of an equity security based on the purchase or sale of a security-based swap, only to the extent that the SEC, by rule or regulation, determines after consultation with the prudential regulators and the Secretary, that such purchase or sale provides incidents of ownership comparable to direct ownership of the equity security, and that such determination is necessary in order to achieve the purposes of Section 13.

ii. Securities Act of 1933

Security-based swaps are now considered to be “securities” for purposes of the Securities Act. Section 768 also provides that, unless a registration statement is in effect as to a security-based swap, it shall be unlawful for any person, directly or indirectly, to offer to sell, offer to buy, or purchase or sell a security-based swap to any person who is not an eligible contract participant.

iii. Investment Advisers Act of 1940 and Investment Company Act of 1940

No changes have been made to the definitions of “security” under the Investment Advisers Act and the Investment Company Act. Similarly, the state-law definitions of “security” have also been left intact.
A. Summary

This title of the Dodd-Frank Act creates a new regulatory framework for the regulation and supervision of payment, clearance, and settlement activities that are determined by the federal regulatory authorities to be of systemic importance. The framework in question provides for the risk-based regulation and supervision of designated FMUs and financial institutions that are engaged in financial activities that are part of the process of clearing and settlement of payments, securities and other financial transactions (covered financial transactions). As stated in the findings provisions of Title VIII (Section 801(b)), its essential purpose is to “mitigate systemic risk in the financial system and promote financial stability” through the regulation and supervision of systemically significant payments, clearance, and settlement facilities and participants. In this manner, Title VIII presumably will complement the systemic risk regulatory authority given to the FRB, FSOC, and other federal financial regulators under Titles I and III of the Dodd-Frank Act.

The regulatory authority granted under Title VIII, which will be exercised primarily by the FRB in consultation with FSOC, the SEC, CFTC and other federal prudential regulators, includes broad regulatory authority to require systemically significant FMUs to adopt and adhere to risk-based standards for their operations and activities. In addition, the FRB and other financial regulators will have broad authority to examine designated FMUs and financial institutions with respect to their covered financial transactions, and take remedial enforcement actions against FMUs and financial institutions that engage in activities that present systemic risks or fail to adhere to their risk-based policies and procedures required under this Title.

One practical impact of Title VIII will be to subject a broad range of financial institutions engaged in payment, settlement, and clearance activities, plus a smaller number of institutions that become subject to the risk-based supervisory requirements for systemically significant FMUs, to a separate risk-based supervision and enforcement program that will be administered primarily by the FRB, in consultation with other prudential agencies. By the same token, the FRB and the affected federal financial regulatory agencies will be confronted with the need to assure the proper coordination of their supervisory activities to minimize supervisory conflicts and redundancies, among other things, and harmonize their activities under this Title with their broader systemic supervisory activities under other Titles of the Dodd-Frank Act.
B. Designation of Systemically-Important Financial Market Utilities and Payment, Clearing, or Settlement Activities

1. Definition of an FMU

An FMU is defined as a person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities or other “financial transactions” among financial institutions or between financial institutions and itself. Importantly, SEC- or CFTC-regulated securities and commodities exchanges, designated contract markets, trading or execution facilities, or data repositories are not included in the definition of an FMU solely by reason of their performance of activities that require their registration as such. Regulated securities and commodities entities and professionals, such as broker-dealers, investment companies, transfer agents, and similar persons providing such services or acting on behalf of an FMU in connection with the furnishing of FMU services, similarly are not included in the definition of an FMU, provided that such services are not “critical risk management or processing functions” of the FMU. This provision arguably may be of interest and concern to “mission critical” vendors and providers of services to a designated FMU.

2. Financial Transactions Covered

The definitions for financial transactions are significant in that they form a foundation for the regulatory scheme created by Title VIII. A financial transaction includes a broad range of funds transfers, securities, and commodity contracts, swaps, repurchase agreements, and derivatives contracts, as well as “any similar transaction” that the FSOC determines to be a financial transaction under Title VIII. A payment, clearing, and settlement of a financial transaction includes the process customarily associated with such functions (trade calculations, netting, funds transmittals and movements, final transaction settlement activities) as well as functions such as “provision and maintenance” of trade information, risk management activities associated with continuing financial activities, and again, any other “similar functions” that the FSOC may determine. The FSOC, therefore, is given substantial latitude to modify or expand the range of activities subject to regulation under Title VIII.

3. The Process for Designating an FMU or a Financial Activity as Systemically Significant

The regulatory and supervisory framework and regulatory powers granted under Title VIII apply to designated FMUs and financial transaction payment, clearing, or settlement activities (covered financial activities). Under Section 804, the FSOC, upon a two-thirds vote of its members, is required to designate those FMUs and
covered financial transactions that the FSOC determines are or are likely to become systemically important, taking into account certain specified considerations such as the aggregate monetary value of transactions processed, the aggregate exposure of an FMU or financial institution engaged in covered financial activities, the interdependence of these FMUs or activities, the systemic impact of a failure or disruption of an FMU or covered financial activities, and other factors deemed appropriate by the FSOC. Similar to the designation process incorporated in the systemic risk supervision provisions of Title I, Section 804 creates a process for FMU and covered financial activity designations and rescissions, consultations among the FSOC, the FRB and other regulators as part of the designation and rescission process, and notice and hearing procedures for the same. In addition, the FSOC is given emergency powers to waive or modify the normal designation procedures as necessary to prevent or mitigate “immediate threats” to the financial system.

C. Standards for Systemically-Important FMUs and Payment, Clearing, or Settlement Activities

In keeping with the tenor of Title VIII and the Dodd-Frank Act’s larger objective of more comprehensive systemic risk regulation, Section 805 of Title VIII directs the FRB, in consultation with the FSOC and other interested financial regulatory agencies (the bank regulatory agencies, the SEC and the CFTC), to prescribe “risk management standards” for designated FMU operations and activities, and the conduct of designated financial activities (Section 805 activities) by financial institutions. Designated FMUs that are SEC- or CFTC-registered clearing organizations are subject to special procedures prescribed by the SEC or CFTC, respectively, although the FRB has the authority to determine that these special policies and procedures are insufficient to prevent or mitigate risks to the financial markets or US financial stability. Disagreements between the FRB and the SEC or CFTC in this regard are subject to resolution by the FSOC by a two-thirds majority vote, with the FSOC having the right to direct the SEC or CFTC to prescribe risk management standards as determined by the FSOC. Title VIII further sets forth a variety of principles for the risk management standards for designated FMUs, but does not allow the FSOC or FRB to make substantive swap or securities-based swap clearing determinations that are within the authority of the SEC or CFTC under Title VII of the Dodd-Frank Act.

D. Operations of Designated FMUs

1. Access to Federal Reserve System Facilities

Designated FMUs receive modest government financial benefits under Title VIII, including the ability to maintain accounts at a Federal Reserve Bank. In addition, a Federal Reserve Bank may (but is not required to) pay interest on balances maintained by or on behalf of a designated FMU, and the FRB may exempt or
modify any deposit reserve requirements applicable to a designated FMU. At the same time, designated FMU access to the Federal Reserve System discount window and other credit facilities is limited to “unusual or exigent circumstances” that require a majority FRB vote after consultation with the Secretary and a showing by the designated FMU that it cannot obtain “adequate credit accommodations” elsewhere.

2. Changes to Rules, Procedures, and Operations

Title VIII establishes an advance notice process for designated FMUs wanting to make changes to their rules, procedures or operations that could “materially affect” the nature or level of risks presented by the designated FMU, as defined by rules of the FMU’s primary supervisory agency.

E. Examination of and Enforcement Actions Against Designated FMUs

Designated FMUs remain subject to the supervisory and enforcement jurisdiction of their primary federal supervisory agencies, but each primary supervisor for a designated FMU is required to examine each such FMU annually to determine the nature of the operations of and the risks borne by the designated FMU, the financial and operational risks presented by the FMU to financial institutions, “critical markets,” or the broader financial system, as well as matters including the FMU’s resources and capabilities, the FMU’s safety and soundness, and its compliance with Title VIII and the rules thereunder. The FRB, however, is required to be consulted in these risk-focused examinations and may participate in them in the FRB’s discretion.

Further, Title VIII creates a means for the FRB to request that a federal supervisory agency take enforcement action against a designated FMU and a binding arbitration process before the FSOC (to be decided by FSOC majority vote) if the primary supervisor disagrees. The FRB also may take emergency enforcement action against a designated FMU, after consultations with the FMU’s primary supervisor and upon an FSOC majority vote, where the actions or condition of the FMU present an “imminent risk of substantial harm” to financial institutions, “critical markets,” or the broader financial system. The enforcement powers that the FRB may exercise are the same as those provided under Section 8 of the FDIA.

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

Title VIII creates a parallel examination and enforcement scheme for financial institutions that are engaged in Section 805 activities. In addition to the regular supervisory and enforcement activities of their primary federal supervisory agency, financial institutions that are engaged in Section 805 activities are subject to separate examination and
enforcement by their primary federal supervisors with respect to the nature and scope of their Section 805 activities, the financial and operational risks presented by them, and similar risk-focused matters. The FRB is directed to consult with and provide technical assistance to a primary federal supervisory agency as may be required to assure that Title VIII’s rules and orders are consistently interpreted and applied. Moreover, a financial institution’s primary supervisor may request the FRB to participate in or conduct an examination of the financial institution’s Section 805 activities, and the primary supervisor may request the FRB to enforce, under FDIA Section 8, Title VIII or its rules or orders against a financial institution with respect to its Section 805 activities. The FRB also is given broad backup examination and enforcement authority with respect to financial institutions and their Section 805 activities, subject to the limitation that the FRB has “reasonable cause” to believe that the financial institution is not in compliance with Title VIII and follows other notification and consultation procedures.

G. Requests for Information and Other Coordination Matters

1. Requests for and Access to Designated FMU and Financial Institution Information

Title VIII also creates a mechanism for access to and sharing of information among the FSOC and the various federal supervisory agencies that supervise designated FMUs and Title VIII financial institutions and activities. The FSOC can require any FMU (not just designated FMUs) to provide information, upon reasonable cause, to assess whether the FMU is systemically important, and may require any financial institution (also upon reasonable cause) to supply information to allow the FSOC to determine if the financial institution is engaged in systemically important Section 805 activities. The FRB and FSOC also may request information from financial institutions that are engaged in Section 805 activities, and the FRB, with majority approval by the FSOC, may prescribe Title VIII recordkeeping rules for financial institutions and designated clearing entities. Title VIII also creates a mechanism for consultations among the FRB, FSOC, and primary supervisory agencies for the exchange of supervisory reports and other information.

2. Coordination Activities

In the case of designated clearing entities subject to SEC or CFTC jurisdiction, the SEC and the CFTC are directed to consult with the FRB in the development of joint risk management supervision programs for such entities and report on such programs to Congress not later that one year after the Dodd-Frank Act’s enactment.
TITLE IX – INVESTOR PROTECTIONS AND IMPROVEMENTS TO THE REGULATION OF SECURITIES

A. Summary

Title IX of the Dodd-Frank Act includes a wide assortment of provisions intended generally to bolster protections to securities investors, strengthen the SEC, and improve the application and enforcement of existing provisions of the federal securities laws. The most significant of the foregoing changes (i.e., those most likely to affect materially the securities industry) are summarized below. In addition, Title IX of the Dodd-Frank Act contains a number of modest changes to laws other than the federal securities laws—e.g., the creation of a program to consider making grants to state regulators to study enhanced protections for seniors being targeted by insurance-related advertising—that are not addressed below in the interest of relative brevity and emphasis on the provisions that better fit together within this title. Similarly, the Dodd-Frank Act makes a number of technical corrections to the federal securities laws and conforming amendments to the PUHCA, but these non-substantive changes are not addressed herein.

B. Investor Protection

The Dodd-Frank Act enacts a significant number of investor protection measures, including a few provisions adopted by the Conference Committee in ways that are different than as proposed in the original House-passed and Senate-passed bills.

1. Fiduciary Duty for Broker-Dealers

In a compromise reached by the Conference Committee, the Dodd-Frank Act requires the SEC to conduct a six-month study on the need to impose a fiduciary duty on broker-dealers providing personalized investment advice to retail customers. In conducting this study, the Dodd-Frank Act directs the SEC to consider 14 specific factors, such as the effectiveness of existing standards of care applicable to broker-dealers and gaps between those standards and the standards of care applicable to investment advisers. At the conclusion of the study, the SEC is required to submit a report on its findings to the SBC and HFSC. After the conclusion of the study, if gaps or overlaps exist, the SEC is directed to promulgate rules under statutory authority broadened by the Dodd-Frank Act to remediate gaps or overlaps and harmonize enforcement efforts with respect to broker-dealers and investment advisers.
2. **Establishment of the Investor Advisory Committee**

The Dodd-Frank Act establishes within the SEC an Investment Advisory Committee comprised of:

- an Investor Advocate (a newly created position within the SEC appointed by, and reporting directly to, the Chairman of the SEC)
- a representative of state securities commissions
- a representative of the interests of senior citizens
- between 10 to 20 additional members who are appointed by the SEC

The Investment Advisory Committee is tasked with advising and consulting with the SEC on:

- the SEC’s regulatory priorities
- the substance of proposed SEC regulations
- legislative proposals, as well as initiatives by the SEC to protect investors and promote investor confidence and market integrity

3. **Management and Funding of the SEC**

Title IX of the Dodd-Frank Act contains a number of provisions intended to improve the management of the SEC. Some of these improvements are to be determined through study.

i. **Management and Organizational Changes**

- Two of the operating divisions of the SEC (i.e., Investment Management and Trading & Markets) are given staffs of examiners for conducting inspections and examinations of entities regulated by those divisions. This appears to undermine, if not entirely dissolve, the SEC’s existing Office of Compliance, Inspections and Examinations.
- The SEC is granted streamlined hiring authority for “market specialists.”
- The SEC’s Investor Advocate (appointed by the SEC Chairman to lead a new office within the SEC) must appoint an Ombudsman who will act as a liaison between retail investors and the SEC in resolving issues with the SEC and/or the securities SROs.
- The Chairman of the SEC (along with Chairmen of the FRB, CFTC, NCUA, and the PBGC) must take action to address deficiencies identified by a report of investigation of the SEC (or other agencies’
respectively) Inspector General or certify to Congress that no action is required.

ii. Funding

- As agreed by the Conference Committee, the SEC will not be fully self-funded as was proposed in the original Senate-passed bill but will be permitted to create and maintain a reserve fund from its revenues (with such fund not to exceed $100 million) separate from any amount allocated by the federal budget and to be used at the SEC’s discretion in running agency business.
- Similarly, the SEC will enjoy a specifically designated budget of significant size for the next five years—$1.3 billion in 2011, $1.5 billion in 2012, $1.75 billion in 2013, $2 billion in 2014, and $2.25 billion in 2015—although more money than these amounts may ultimately be appropriated.
- The SEC will utilize a modified budget request process going forward under which it will submit its future budget requests directly to Congress in addition to submissions to the President or OMB (rather than going exclusively through the White House).

iii. Reports and Studies

- The SEC must hire a consultant to study its operations and the possible need for comprehensive reform of the agency, and the consultant must, within the 150 days of being retained, make a report to the SEC and Congress making legislative, regulatory and administrative recommendations for improving the SEC.
- No later than six months after the consultant issues the report noted above, the SEC must report to the SBC and HFSC regarding the SEC’s implementation of the recommendations, and the SEC must follow this initial report with subsequent reports every six months for two years thereafter.
- The Comptroller General of the United States must study issues surrounding employees who leave the SEC for employment with regulated firms in the securities industry and make a report to the SBC and HFSC within one year of enactment.
- The SEC must make an annual report to the SBC and HFSC assessing the effectiveness of the SEC’s internal supervisory controls and the procedures used to perform examinations, investigations, and reviews of regulated entities.
• The SEC must make a report to the SBC and HFSC within 180 days of enactment regarding the effectiveness of the SEC’s current framework for examining investment advisers.

• The Comptroller General must make reports to the SBC and HFSC once every three years on the quality of the SEC’s (a) personnel management, (b) internal supervisory controls and procedures, and (c) oversight of national securities associations (FINRA).

• The Comptroller General must make a report to the SBC and HFSC within 180 days of enactment regarding the effectiveness of state and federal regulation of persons who hold themselves out as financial planners or as otherwise providing financial planning services.

• The Comptroller General must make reports to the SBC and HFSC within 18 months of enactment regarding the effectiveness of (a) regulation of mutual fund advertising, and (b) conflicts of interest between the staffs of investment banking on the one hand and analysts on the other.

• The SEC and the Comptroller General must each make annual reports to Congress regarding the SEC’s financial controls.

C. Enforcement of the Federal Securities Laws

The Dodd-Frank Act includes the following provisions intended to increase regulatory enforcement and remedies under the federal securities laws:

• The SEC is authorized to consider prohibiting, conditioning, or limiting the use of mandatory pre-dispute arbitration agreements by broker-dealers and investment advisers in matters arising under the federal securities laws and rules thereunder.

• The SEC is directed to establish an Investor Protection Fund funded through revenues from certain sanctions. The Fund is to be used to pay whistleblowers who provide original information in an SEC action not less than 10 percent of the total collected nor more than 30 percent of the total collected in sanctions resulting from such SEC action (and certain related actions by other regulators or courts).

• The SEC is permitted to impose collateral bars under the Exchange Act and the Advisers Act, thus prohibiting violators from associating with a broad range of SEC-regulated firms rather than only those entities regulated under the particular federal securities law under which the violation occurred.

• The SEC is directed to issue rules disqualifying certain “bad actors” (e.g., felons) from offering securities pursuant to Regulation D under Securities Act.

• The SEC is permitted to make nationwide service of subpoenas in civil actions filed in federal courts.

• The SEC’s authority to bring actions is formally extended to persons formerly associated with SEC registrants (e.g., broker-dealers), thus foreclosing the possibility
that violators could potentially escape sanction or penalty by disassociating from such registrants.

- The SEC is permitted to share privileged information with non-US authorities without waiving applicable privileges with respect to that information, and the SEC is prohibited from disclosing privileged information received from such non-US authorities.
- The scope of the Exchange Act’s provisions on market manipulation and short sales is extended by making those provisions applicable to any securities other than government securities (in place of current limitation of securities traded on a national securities exchange).
- The SEC is given authority to bring aiding and abetting charges under the Securities Act and the ICA.
- The SEC is given uniform authority to seek civil penalties in cease and desist proceedings.
- The SEC is required to complete investigations and examinations within 180 days unless the investigation or examination meets certain complexity criteria.
- The limit for protecting cash claims against an insolvent broker-dealer being liquidated by SIPC is raised from $100,000 to $250,000 (as adjusted for inflation going forward).

1. **Extraterritorial Application of Anti-fraud Provisions**

   The anti-fraud provisions of the federal securities laws are extended to apply expressly to “conduct within the United States that constitutes significant steps in furtherance of [a] violation, even if the securities transactions occur outside the United States and involve only foreign investors” and “conduct occurring outside the United States that has a foreseeable substantial effect within the United States.”

   The SEC must solicit public comment and thereafter conduct a study regarding whether the standards for extraterritorial application of the anti-fraud provisions of the federal securities laws should also form the basis for the extraterritorial exercise of private rights of action, and the SEC must report its findings to the SBC and HFSC within 18 months of enactment.

2. **Securities Lending**

   The SEC must, within two years, issue rules designed to increase the transparency of available information regarding securities lending.
3. Stoneridge Revisited

The GAO must report to Congress within one year of enactment regarding the potential consequences of authorizing a private right of action against any person who aids or abets another person in violation of the federal securities laws (effectively investigating the potential to legislatively overturn the Supreme Court’s ruling in Stoneridge).

D. Improvements to the Regulation of Credit Rating Agencies

In the aftermath of the recent financial crisis, a widely held perception is that the ratings on structured financial products have proven to be inaccurate or at least uninformative to investors. In reality, however, ratings on asset-backed securities did not prove to be inaccurate or uninformative. As of a year ago, AAA-rated asset-backed securities that had gone into default equaled 0.07 percent of the total, and the inaccuracies were overwhelmingly confined to mortgage-backed securities and collateralized debt obligations of mortgage-backed securities. Nevertheless, the Dodd-Frank Act enacts many measures intended to improve the reliability of ratings and operation of the agencies that issue them—NRSROs. The Dodd-Frank Act generally increases internal controls of NRSROs, requires greater transparency of rating procedures and methodologies, clarifies that investors have a private right of action against NRSROs under the Exchange Act (in the same fashion as those rights against registered public accounting firms or a securities analyst), and provides the SEC with greater enforcement tools. In addition, and more specifically:

- The SEC must establish an Office of Credit Ratings specifically designed to administer the SEC’s rules applicable to, and examine annually, NRSROs. The SEC is given latitude in the Dodd-Frank Act to make exceptions for smaller NRSROs as it deems appropriate.
- Each NRSRO must establish and enforce an internal control structure governing the implementation of policies, procedures and methodologies for determining credit ratings in light of factors prescribed by the SEC, and the NRSRO must file annual internal control reports with the SEC.
- With limited exemptions, each NRSRO must designate a compliance officer who is not involved in marketing, sales, or issuance of ratings.
- At least half (no fewer than two people) of the board of directors of NRSROs must be comprised of independent directors, and at least some portion of the independent directors must be users of NRSRO ratings.
- Ratings issued by NRSROs shall no longer be considered “forward-looking statements” under the litigation safe harbor in Section 21E of the Exchange Act, and Securities Act Rule 436(g) is automatically rescinded, thus subjecting NRSRO analysts to liability under that Act in the same manner as accountants when ratings are included in registration statements.
• Each NRSRO must refer to applicable authorities any credible information received from a third party alleging that an issuer rated by the NRSRO has committed or is committing a material violation of law.
• In producing ratings, NRSROs must consider credible and potentially significant information received from sources other than an issuer when rating the issuer’s securities.

1. **Rulemaking Required**

• Generally, within one year of enactment, the SEC must issue rules to:
  ▪ prevent the sales and marketing considerations of NRSROs from Influencing ratings
  ▪ require each NRSRO to include with each rating a prescribed disclosure form about the assumptions and data underlying ratings and the methodologies used in issuing the ratings
  ▪ require each NRSRO to disclose information on initial ratings and subsequent changes for purposes of allowing investors a means of assessing accuracy and establishing comparability across NRSROs
  ▪ ensure that any rating analyst employed by an NRSRO meets standards of training, experience and competence

• Within 90 days of enactment, the SEC must revise Regulation FD to remove the exemption for ratings agencies.
• Within one year of enactment, each federal agency must review its regulations requiring the use of credit ratings with a goal of modifying those regulations by substituting for such use the standard of credit-worthiness it deems appropriate and, upon completion of this review, must transmit a report to Congress describing the modifications so made.

2. **Reports and Studies**

• The SEC must study, and submit a report to the SBC and HFSC within three years of enactment regarding, the independence of NRSROs and how this independence (or lack thereof) affects ratings.
• The Comptroller General must study, and submit a report to the SBC and HFSC within 18 months of enactment regarding, alternatives to the current ratings models (i.e., the use of NRSROs).
• Within one year after the SEC issues rules related to qualifications of ratings analysts, the GAO must study, and submit a report to the SBC and HFSC regarding, the feasibility of creating an independent professional analyst organization.
i. Franken Amendment

In what was a highly contentious issue, the Conference Committee ultimately agreed to task the SEC with studying the establishment of a system in which a public or private utility or a SRO assigns NRSROs to determine the ratings of structured finance products (e.g., collateralized debt obligations) rather than implementing such mechanism directly. As part of this compromise, the SEC is further obligated to issue a report within 24 months of enactment to the SBC and HFSC with the findings of this study and recommendations for further action. Importantly, the Dodd-Frank Act grants rulemaking authority to the SEC under which the SEC may implement an assignment system for ratings as it deems appropriate after the study and report are concluded, although the SEC is directed to consider a provision from the original House-passed bill that was not directly included within the Dodd-Frank Act.

E. Improvements to the Asset-Backed Securitization Process

Title IX of the Dodd-Frank Act amends the Exchange Act to define formally “asset-backed security,” “securitizer,” and “originator,” with each such definition largely tracking what had been understood as terms of art customarily used in securitizations. In addition, the Dodd-Frank Act tasks certain regulators with responsibility for regulating various aspects of asset-backed securities transactions.

1. Risk Retention

Not later than 270 days after enactment of the Dodd-Frank Act, the SEC, FRB, FDIC, and OCC must jointly issue rules requiring a securitizer of an asset-backed security (other than a residential mortgage-backed security) to retain at least 5% of the credit risk in any asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party. These rules shall be effective two years after publication of final version in the Federal Register.

Not later than 270 days after enactment of the Dodd-Frank Act, the SEC, FRB, FDIC, OCC, Secretary of HUD, and Director of the FHFA must jointly issue rules requiring a securitizer of a residential mortgage-backed security to retain at least 5% of the credit risk in any asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party. These rules
shall be effective one year after publication of final version in the *Federal Register*.

- Securities backed by “qualified residential mortgages” will be excepted from these risk retention requirements. The agencies listed above must jointly define the term “qualified residential mortgage.” In doing so, they must consider a number of factors suggestive of a lower risk of default, including:
  - verification of the financial resources relied upon to qualify a mortgagor;
  - standards with respect to the residual income of the mortgagor after all monthly obligations, the ratio of the housing payments of the mortgagor to the monthly income, and the ratio of total monthly installment payments to income;
  - mitigating the potential for payment shock on adjustable rate mortgages;
  - mortgage guarantee insurance or other types of credit enhancement obtained at the time of origination; and
  - prohibitions or restrictions on the use of balloon payments, negative amortization, prepayment penalties, interest-only payments, and other similar “risky” features.

- As a practical matter, commercial mortgage-backed securities will be subject to differing requirements than residential mortgage-backed securities. For example, for commercial mortgage-backed securities, the applicable agencies are, during their risk retention rulemaking, permitted by the Dodd-Frank Act to consider retention of the first-loss position by a third-party purchaser.

In rulemaking efforts for all asset-backed securities (including residential mortgage-backed securities), the responsible agencies may allocate the risk retention obligation between a securitizer and originator, where applicable. Moreover, the agencies may craft total or partial exemptions, exceptions and adjustments for any securitization (e.g., assets guaranteed by the United States, other than Fannie Mae or Freddie Mac), classes of institutions, classes of assets, and hedging of risk as deemed appropriate. In all cases, the Chairman of the FSOC is tasked with coordinating the foregoing rulemaking efforts.

2. **Third-Party Due Diligence Reports**

The issuer or underwriter of any asset-backed security must make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.
3. Studies and Additional Rulemaking

- The SEC, FRB, FDIC, and OCC are required to report to Congress within 90 days of enactment on the risk retention issues and rulemaking described above. Similarly, the Chairman of the FSOC is required to carry out a study, and make a report to Congress, on the macroeconomic effects of the risk retention requirements.
- The SEC must issue rules requiring each NRSRO to include in any report accompanying a credit rating a description of the representations, warranties, and enforcement mechanisms available to investors (and how they differ from issuances of similar securities).
- The SEC must issue disclosure rules applicable to issuers of asset-backed securities addressing the (a) format of data and comparison of data, (b) asset level data, (c) compensation for brokers, and (d) amount or retention.

F. Corporate Governance

Title IX of the Dodd-Frank Act includes a number of provisions intended to provide shareholders with greater influence over, and insight into, the activities of publicly held companies. In some cases, these provisions are extensions or clarifications of existing regulation of the national securities exchanges. In other cases (e.g., proxy rules), the provisions go well beyond existing law.

1. Executive Compensation

The key compensation-related provisions of the Dodd-Frank Act include:

- Effective six months after enactment, publicly traded companies must hold a non-binding vote to approve the compensation of executives who are among those disclosed in public filings pursuant to SEC rules (i.e., say-on-pay votes) at least once every three years, and a separate resolution must be offered at least once every six years for a vote to determine whether say-on-pay votes should occur every one, two, or three years.
- After much discussion, the Conference Committee also agreed to require these companies to provide a non-binding vote to approve golden parachutes as well (also effective six months after enactment).
- Institutional investment managers subject to Section 13(f) of the Exchange Act must annually disclose how they vote on say-on-pay and golden parachute matters unless their votes are otherwise publicly reported under SEC rules.
- The Dodd-Frank Act places ultimate responsibility for compensation decisions for executives at these companies with the companies’ respective Compensation Committees, which must be comprised of independent
directors and advised by compensation consultants, legal counsel, and other advisers who are independent as well.

- The SEC is required to amend item 402 of Regulation S-K under the Securities Act to require companies to disclose the relationship between executive compensation and financial performance and the ratio between the CEO’s compensation and the median compensation of all other employees.

- The national securities exchanges on which public companies are traded shall, as directed by the SEC, enforce requirements in the Dodd-Frank Act for clawing back incentive compensation paid to executives mistakenly paid based on erroneous results later corrected and restated within three years of such payment.

- The SEC is required to issue a rule requiring publicly traded companies to disclose whether executives are permitted to hedge the value of any equity securities granted to such executives as compensation.

- The SEC is tasked with conducting a study, and reporting to Congress within two years of enactment, regarding the use by publicly traded companies of compensation consultants.

- The FRB, in consultation with the OCC and FDIC, is tasked with establishing standards making it an unsafe and unsound practice for the holding companies of depository institutions to pay compensation that is excessive or could lead to material financial loss to the holding companies.

- National securities exchanges are directed to maintain rules-based prohibitions on broker-dealers voting securities on a discretionary basis for shareholders of public companies listed on those exchanges in connection with the election of directors, executive compensation, or any significant matter (as determined by the SEC).

2. Proxy Access

As another contentious matter on which the Conference Committee agreed late in the negotiating process, the SEC may, but is not required to, issue rules requiring public companies to include in their proxy solicitations nominees for directors submitted by shareholders. The SEC also must issue rules requiring publicly traded companies to disclose to shareholders in annual proxies the reasons why the companies have chosen the same person to serve as chairman and CEO or different persons as chairman and CEO.

G. Municipal Securities

The Dodd-Frank Act makes a number of changes to the regulation of persons involved in municipal securities businesses, including:

- Municipal advisors (persons who provide advice to municipalities with respect to the issuance of municipal financial products) will be required to register as such under the
Exchange Act and must act as fiduciaries with respect to the municipal entities to whom they provide advice.

- The MSRB must be reconstituted with a majority of board members who are not affiliated with broker-dealers, municipal dealers, or municipal advisors, and the reconstituted MSRB will have broadened powers that include authority over municipal advisors.
- The GAO is tasked with studying, and making a report to Congress on, (a) the municipal securities markets (within 18 months of enactment), and (b) disclosures made by issuers to investors therein (within 24 months of enactment).
- The SEC must establish an Office of Municipal Securities to administer SEC rules related to municipal securities in coordination with the MSRB.

H. Public Company Accounting Oversight Board

The Dodd-Frank Act makes a couple of significant changes to the operation and role of the PCAOB. First, the PCAOB is permitted to share privileged information with non-US auditor oversight authorities without waiving applicable privileges. Second, the PCAOB is authorized to review auditors of broker-dealers and to release information about those broker-dealers to the broker-dealers SROs.
A. Summary

Title X creates a new federal entity, the BCFP, whose broad mission is to regulate financial products or services provided by insured depository institutions, finance companies, mortgage lenders, and a broad range of nontraditional financial services entities. The establishment of an independent agency to serve the interests of retail financial consumers was a central tenet of the Obama Administration’s original financial services reform proposal. It reflected a reaction to perceived lapses on the part of the banking agencies to supervise effectively the consumer lending activities of banks and other consumer credit providers, as well as the lack of any federal oversight over certain nonbank providers. As a result, the BCFP will have supervision, examination, and enforcement authority over most providers of consumer financial products and services, leaving the federal banking agencies and the FTC to act as back-up regulators. The BCFP will have broad authority to regulate the provision of consumer financial products and services. The Dodd-Frank Act will also significantly reduce the ability of the OCC to preempt state consumer protection laws for the benefit of national banks and federal thrifts, and will expose those institutions to a higher risk of enforcement actions on the part of State AGs.

B. Bureau of Consumer Financial Protection

1. Establishment

While the House Bill would have created a new, fully independent federal agency headed initially by a director and thereafter by a five-person commission, this was ultimately abandoned in favor of the structure contained in the original Senate-passed bill. The Dodd-Frank Act places the BCFP within the FRB and provides that the director of the BCFP (the “Director”) will be appointed for a five-year term by the President, with the advice and consent of Senate. The Director will be a member of the FSOC and the FDIC’s Board of Directors. Although the BCFP is a bureau within the FRB, the Dodd-Frank Act expressly prohibits the FRB from intervening in any examination or enforcement action, appointing or removing any officer or employee of the BCFP, or merging or consolidating the BCFP.
2. Structure

The Dodd-Frank Act is very specific as to how the BCFP is to be organized. It is to have specific functional units focused on the following areas: research, community affairs, and collecting and tracking complaints. In addition, the BCFP will have four subordinate offices focused on protecting historically vulnerable groups of individuals: the Office of Fair Lending and Equal Opportunity, the Office of Financial Education, the Office of Service Member Affairs, and the Office of Financial Protection for Older Americans. The Secretary and the Director are also required to designate a private education loan ombudsman within the BCFP to provide timely assistance to borrowers of private education loans.

The Director is also required to establish the CAB, comprised of experts in consumer protection, financial services, community development, fair lending, and consumer financial products or services, as well as representatives of depository institutions that primarily serve underserved communities, and representatives of certain communities of industry and consumers, to advise and consult with the BCFP in the exercise of its functions under the federal consumer protection laws, and to provide information on emerging practices and trends in the consumer financial products or services industry.

C. Funding of the BCFP

The BCFP will be funded primarily from the FRB’s budget rather than from assessments on insured depository institutions and nondepository institutions, or through the budget appropriations process. To avoid potential conflicts and indirect control by the FRB, the BCFP will receive an amount not to exceed 10 percent of the FRB’s total operating expenses in fiscal year 2011, 11 percent for fiscal year 2012, and 12 percent for fiscal year 2013 and beyond (with annual adjustments based upon the employment cost index for state and federal government workers published by the federal government). If such funds are insufficient to permit the BCFP to carry out its authority, the Director must submit a written report to the President and the Appropriations Committees of the House and the Senate, and these Committees are authorized to appropriate $200 million for each of fiscal years 2010, 2011, 2012, 2013 and 2014.

D. Covered Persons

The Dodd-Frank Act provides the BCFP with the authority to regulate, examine, and take enforcement action with respect to any person that engages in the offering or providing of a “financial product or service” to a consumer and any affiliate of such person, if the affiliate acts as a service provider to such person (“covered person”).
The Dodd-Frank Act broadly defines “financial product or service” to include the following activities:

- lending and servicing loans;
- extending or brokering leases of real or personal property that are the functional equivalent of purchase financing arrangements (subject to certain additional restrictions);
- deposit-taking activities, transmitting or exchanging funds, or otherwise acting as a custodian of funds or other financial instruments for consumers;
- providing real estate settlement services (to the extent not expressly excluded);
- selling, providing, or issuing stored value or payment instruments (subject to certain limitations for sellers);
- providing check cashing, check clearing, or check guaranty services;
- providing payments or other financial data processing services to a consumer by technological means;
- providing financial advisory services;
- collecting, providing, analyzing or maintaining consumer report information, or other account information (subject to certain exceptions);
- debt collection; and
- any other financial product or service that the BCFP defines by regulation, (A) entered into or conducted as a subterfuge to avoid a federal consumer financial law, or (B) permissible for a bank or BHC to offer.

E. **Supervision, Examination and Enforcement Authority**

The Dodd-Frank Act consolidates the consumer protection supervisory and enforcement authority, and capabilities that currently are shared among the federal banking agencies and the FTC, and grants additional authority to the BCFP to examine and take enforcement actions against non-bank providers of consumer financial products and services, including mortgage lenders, mortgage brokers, and other providers of consumer financial products and services that historically have not been subject to direct federal supervision or examination. For larger, traditional banks and thrifts, the federal bank regulatory agencies (OCC, FDIC, FRB and NCUA) will be relegated to the role of back-up consumer protection regulator.

1. **Nondepository Institutions**

The Dodd-Frank Act authorizes the BCFP to supervise, examine, and take enforcement action over any covered person who:

- offers or provides origination, brokerage, or servicing with respect to residential real estate loans;
• is a “larger participant” in a market for other consumer financial products or services to be defined in a regulation to be issued by the BCFP not later than one year after the designated transfer date (as defined below);
• the BCFP determines, by order (after notice and opportunity to respond), based upon complaints received, that the person is engaging or has engaged in a pattern of conduct that poses undue risk to consumers with respect to the offering or provision of a consumer financial product or service;
• offers or provides any private education loan; or
• offers or provides any payday loan.

Although not required to do so, the BCFP may impose registration requirements on nondepository institutions, and make that registration information publicly available, so that consumers can identify persons registered with the BCFP.

2. **Banks, Thrifts, and Credit Unions**

The BCFP has supervision, examination, and enforcement authority over any covered person that is:

• an insured depository institution with total assets of more than $10 billion in assets, and any affiliate thereof; or
• any insured credit union with total assets of more than $10 billion, and any affiliate thereof.

For insured depository institutions and credit unions with $10 billion or less in total assets, their primary federal bank regulatory agency (OCC, FRB, FDIC and NCUA) will retain responsibility for examination and enforcement of their compliance with federal consumer protection laws. However, the BCFP may appoint its own examiners, on a sampling basis, to participate in examinations performed by the prudential regulators.

3. **Service Providers**

A service provider to any covered person is subject to the authority of the BCFP to the same extent that the service provider would be covered if it was engaged in a service relationship with a bank and the BCFP were a federal banking agency under the Bank Service Company Act.

**F. Exempt Entities**

The following persons or activities are expressly exempted from the jurisdiction of the BCFP:
persons regulated by the SEC;
- persons regulated by the CFTC;
- persons regulated by a state insurance regulator;
- persons regulated by a state securities commission;
- persons regulated by the Farm Credit Administration;
- merchants, retailers and others sellers of nonfinancial goods and services;
- merchants, retailers and other sellers offering or providing certain consumer financial products or services in connection with the sale or brokerage on nonfinancial products or services (except to the extent that the merchant assigns, sells or conveys the debt to another person, the credit extended significantly exceeds the market value of the nonfinancial good or service provided, or the merchant regularly extends credit subject to a finance charge);
- automobile dealers (except to the extent they provide services related to mortgage loans, credit products, or leases directly to consumers and those contracts are not routinely assigned to unaffiliated third parties, or they offer consumer financial products or services not related to motor vehicles);
- accountants and persons performing income tax preparation;
- attorneys engaged in the practice of law;
- employee benefit and compensation plans;
- manufactured home retailers;
- consumer reporting agencies providing background checks;
- qualified tuition programs or other prepaid tuition programs offered by a state;
- activities related to charitable contributions; and
- real estate brokerage activities.

The BCFP, by regulation, may conditionally or unconditionally exempt any class of covered persons, service providers, or any consumer financial products or services from the provisions of the Dodd-Frank Act or implementing regulations. However, in issuing any such exemption, the BCFP must take into account the following considerations: (i) the total assets of the class of covered persons, (ii) the volume of the transactions involving consumer financial products or services in which the class of covered person engages, and (iii) the existing laws applicable to the consumer financial product or service and the extent to which such laws provide consumers with adequate protections.

G. **BCFP Rulemaking**

The Dodd-Frank Act grants broad rulemaking authority to the BCFP and imposes few restrictions other than requiring the BCFP to coordinate with the other federal banking agencies, other federal agencies, and state regulators to ensure consistency in its regulation of consumer products and services. While the federal banking agencies do not have the authority to prevent the BCFP from issuing a regulation, the FSOC has the ability to set aside a BCFP regulation upon a vote of two-thirds of its members. In addition to the supermajority vote requirement, the process for setting aside a BCFP regulation is
detailed and relatively cumbersome, making it unlikely as a practical matter that the FSOC will be able easily to override BCFP regulations.

To the extent that the BCFP issues rules addressing a particular substantive area of the law, these rules will not preempt state consumer financial laws. However, as is the case with many federal consumer protection statutes today, states are generally free to implement their own laws that provide greater protection than the standards set forth in these federal statutes. In these circumstances, the BCFP rulemaking would establish the floor and more stringent state laws would generally apply to banks and other providers of consumer financial products and services. Therefore, many BCFP rulemakings will increase the compliance burden faced by entities operating on a nationwide basis by requiring compliance with another set of regulations.

The BCFP’s key rulemaking authorities include:

1. **Enumerated Consumer Laws**

   The BCFP has exclusive rulemaking authority with respect to existing federal consumer laws, including the:

   - Alternative Mortgage Transaction Parity Act
   - EFTA
   - ECOA
   - FCRA
   - Fair Debt Collection Practices Act
   - GLBA’s privacy provisions
   - HMDA
   - RESPA
   - SAFE Act
   - TILA
   - Truth-in-Savings Act

2. **Unfair, Deceptive, or Abusive Acts or Practices**

   The BCFP is authorized to prescribe regulations designed to prevent a covered person or service provider from committing or engaging in an unfair, deceptive, or abusive act or practice in connection with a transaction involving a consumer financial product or service. In order to declare an act or practice unfair, the BCFP must have a reasonable basis to conclude that the act or practice causes, or is likely to cause, substantial injury to consumers which is not reasonably avoidable by the consumer and the injury is not outweighed by countervailing benefits to the consumer or to competition. The BCFP has no authority to declare an act or practice abusive unless it (i) materially interferes with the ability of a consumer to
understand a term or condition of the consumer financial product or service, or (ii) takes unreasonable advantage of (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions, (B) the inability of the consumer to protect his or her interests in selecting a product or service, or (C) the reasonable reliance by the consumer on the covered person to act in the interest of the consumer.

3. Mortgage Lending

The BCFP has the authority to issue regulations prohibiting terms, acts, or practices relating to residential mortgage loans that it finds to be abusive, unfair, deceptive, predatory, necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers.

H. BCFP Coordination with Other Agencies

During Congressional consideration of the Dodd-Frank Act, financial services industry representatives expressed substantial concerns over the creation of a new federal regulator and the negative impact of separating safety and soundness regulation from consumer protection supervision. In response to those concerns, Congress designated a number of areas where the BCFP must coordinate with other agencies. For example, the BCFP is required to coordinate with the SEC, CFTC, FTC and other federal and state regulators to promote consistent regulatory treatment of consumer financial and investment products and services. Likewise, the BCFP and the FTC are required to negotiate an agreement for coordinating on enforcement actions against nondepository institutions and service providers. The Dodd-Frank Act contemplates that this agreement will include notice to the other agency (to the extent possible) before initiating a civil action against a covered person.

For nondepository institutions, the BCFP is required to coordinate its supervisory activities with those of the federal prudential regulators and state banking authorities and, to the fullest extent possible, use existing reports and publicly reported information to discharge its monitoring functions. The BCFP is granted access to any report of examination or financial condition made by a federal banking agency or other federal agency having jurisdiction over a covered persons or service provider. The federal banking agencies have access to any report of examination or financial condition prepared by the BCFP.

I. Federal Preemption

Although not as broad as earlier versions of the legislation, the final version of the Dodd-Frank Act significantly reduces the ability of national banks and federal thrifts to rely upon federal preemption of state consumer financial laws. This result is a significant victory for
the Administration, Democrats in Congress, and State AGs, who, in the name of leveling the financial services playing field, sought to eliminate or greatly restrict federal preemption. In addition to curtailing preemption for national banks and federal thrifts, the Act strips away the ability of operating subsidiaries of federally chartered institutions to rely on federal preemption. The lack of strong federal preemption may undercut the ability of national banks and federal thrifts to offer uniform lending products on a nationwide or multi-state basis. Furthermore, it may result in lenders withdrawing from certain markets rather than complying with burdensome state laws and the higher risk of litigation.

1. National Bank and Federal Thrifts

National banks and federal thrifts will now have the same limited preemption rights. These new restrictive provisions permit the OCC and courts to preempt a state consumer financial law only if:

- the application of the state consumer financial law would have a discriminatory effect on national banks or federal thrifts;
- in accordance with the legal standard for preemption articulated by the US Supreme Court in *Barnett Bank of Marion County, N.A. v. Nelson, Florida Ins. Commissioner, et al.*, 517 U.S. 25 (1996), the state consumer financial law prevents or significantly interferes with the exercise by the bank of its powers (and any preemption determination under this subsection may be made by regulation or order of the OCC on a “case-by-case basis”); or
- the state consumer financial law is preempted by a provision of federal law other than the Dodd-Frank Act.

These new statutory preemption standards apply only to “state consumer financial laws,” which, although broadly defined, arguably would not preclude application of broader preemption standards in areas such as trust and fiduciary operations. In addition, the new more restrictive standards generally will not apply to “any contract entered into on or before the date of enactment of the Dodd-Frank Act.”

2. Procedural Restrictions

In addition to substantially narrowing existing preemption standards, the Dodd-Frank Act imposes the following restrictions on preemption determinations by the OCC:

- While preemption determinations must be made on a “case-by-case basis,” the term is defined broadly enough to permit the preemption of other state laws with substantively equivalent terms.
• The OCC must first consult with BCFP in determining whether a state law is substantively equivalent to previously preempted state law and take its views into account.
• Any court reviewing the OCC preemption determinations must assess the validity of those determinations based on the thoroughness of the consideration, the validity of the reasoning, consistency with prior determinations, and other facts that the court finds to be persuasive.
• Preemption determinations must be made by the Comptroller of the Currency and cannot be delegated to any other officer or employee of the OCC.
• The OCC preemption determinations are not valid unless substantial evidence, made on the record of the proceedings, supports the specific finding in accordance with the *Barnett Bank* standard.
• The OCC must periodically review each preemption determination at least once every five years through notice and comment, and publish its decision regarding whether to continue or rescind the determinations; a report regarding such review, and the OCC’s intentions with respect to the determination, must be provided to Congress.
• At least on a quarterly basis, the OCC must publish an updated list of all preemption determinations then in effect that identifies the activities and practices covered by each determination and the state consumer financial law requirements or constraints preempted.

3. **Operating Subsidiaries**

The Dodd-Frank Act provides that state consumer protections laws apply to operating subsidiaries of national banks or federal thrifts to the same extent that these laws apply to any other person, corporation, or other entity subject to state law. This provision eliminates the availability of federal preemption for operating subsidiaries reversing the US Supreme Court’s decision in *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1 (2007). As a result, national banks and federal thrifts may need to consolidate existing operating subsidiaries that provide consumer financial products or services on an interstate basis into the bank.

4. **Exportation of Interest Rates and Fees**

While limiting preemption, the Dodd-Frank Act expressly preserves the right of national banks to “export” interest rates and fees under 12 U.S.C. § 85. Furthermore, the BCFP is not authorized to establish a usury limit applicable to an extension of credit offered or made by a covered person to a consumer.
J. Visitorial Powers

The Dodd-Frank Act amends the NBA and HOLA to clarify that these statutes do not restrict the authority of a state attorney general to bring suit and enforce a subpoena against a national bank or federal thrift in a court of appropriate jurisdiction in connection with the enforcement of an “applicable” (e.g., non-preempted state) law against such bank or thrift. These changes are intended to codify the 2009 US Supreme Court decision in Cuomo v. Clearing House Ass’n, L.L.C., 129 S. Ct 2710 (2009), which generally held that that State AGs could enforce judicial but not administrative subpoenas against national banks in connection with civil lawsuits to enforce non-preempted state laws.

The Dodd-Frank Act also provides that the OCC’s ability to bring actions under Section 5 of Federal Trade Commission Act does not preclude private parties from enforcing similar rights under federal or state law with respect to national banks or federal thrifts.

K. Enforcement Authority for Violations of CFP Act or BCFP Regulations

The Dodd-Frank Act provides the BCFP with broad enforcement power, and would relegate the bank regulatory agencies to the role of back-up regulator with respect to consumer protection matters for institutions with assets in excess of $10 billion.

State AGs are generally permitted to bring actions against third parties to enforce the CFP Act or BCFP regulations. National banks and federal thrifts, however, are only subject to actions by State AGs to enforce BCFP regulations, and not the CFP Act. State AGs also may bring suit against national banks and federal thrifts to enforce non-preempted state and federal consumer financial protection laws. State regulators can bring actions against any entity (other than national banks and federal thrifts) licensed, chartered, or doing business in their state, to enforce the provisions of the CFP Act or BCFP regulations.

To the extent practicable, a state attorney general or state regulator is required to provide written notice and a copy of any complaint to the BCFP before initiating any action against a covered person to enforce any provisions of the CFP Act or the BCFP regulations. Upon receipt of notice, the BCFP may intervene in the action, remove to the appropriate federal court, and appeal any order or judgment.

L. Debit Interchange Fees and Network Restrictions

In what was promoted as an initiative to lower consumer transaction costs in connection with purchases paid with debit cards, an amendment offered by Senator Durbin that was included in the Dodd-Frank Act, requires the FRB to issue a regulation defining permissible debit interchange fees that an issuer may receive or charge. The final regulations are required no later than nine months from the enactment of the Dodd-Frank Act and must establish standards for assessing whether the amount of a debit
interchange fee is reasonable and proportional to the actual cost incurred by the issuer with respect to the transaction. In determining what constitutes a reasonable fee, the FRB is permitted to make adjustments to cover costs incurred by the issuer in preventing fraud in relation to debit transactions, as long as the issuer complies with the fraud-related standards established by the FRB.

There are a couple of exemptions from the debit interchange fee restrictions. First, the regulations do not apply to any issuer that, together with its affiliates, has assets of less than $10 billion. Second, there is an exemption from the debit interchange fee restrictions for (i) cards provided pursuant to a government administered payment program, and (ii) certain reloadable prepaid cards. This second set of exemptions is eliminated after one year if certain overdraft or ATM withdrawal fees are charged as part of the program.

The second part of the Durbin amendment addresses certain card network practices, such as the prohibition on merchants establishing minimum or maximum amounts for credit card transactions, or offering discounts for the use of cash or other payment methods, so long as these discounts do not differentiate on the basis of the issuer or the payment card network. With respect to minimum amounts for credit card transactions, the person establishing any minimum may not (i) differentiate between issuers or between payment card networks, and (ii) establish an amount in excess of $10 (adjusted annually). The establishment of maximum amounts is limited to higher education institutions and federal agencies, so long as these entities do not differentiate between issuers or payment card networks.

M. Miscellaneous Provisions

1. Consumer Reports

Several provisions in the Dodd-Frank Act relate to consumer reports. These provisions include, (i) a requirement that any person taking adverse action based upon information in a consumer report must provide the consumer with his or her credit score, and the information required to understand the score, (ii) a study by the BCFP of the differences between credit scores sold to consumers by consumer reporting agencies, and those provided to creditors, and report its findings to Congress within one year of the enactment date of the Dodd-Frank Act, and (iii) a study by the BCFP on the feasibility of using remittance history in the calculation of credit scores and report to Congress within one year of the enactment date of the Dodd-Frank Act.
2. **Mandatory Pre-Dispute Arbitration**

The BCFP must conduct a study of, and provide a report to Congress concerning, the use mandatory pre-dispute arbitration in connection with the offering or providing of consumer financial products or services. Any subsequent rulemaking regarding mandatory pre-dispute arbitration should be consistent with the findings of this study and applicable to agreements entered into after the end of a 180-day period beginning on the effective date of the regulation.

3. **Consumer Access to Information**

A covered person, upon the consumer’s request, must make available the information about the consumer in its control or possession concerning a financial product or service obtained by the consumer from such covered person. When responding to such a request, a covered person is not required to make available to a consumer any proprietary or confidential proprietary information, such as the model used to generate a credit score, or other risk predictors or information maintained or collected for purposes of detecting or preventing fraud or money laundering.

4. **Truth in Lending Act**

The Dodd-Frank Act expands TILA’s coverage to include non-real estate secured consumer credit transactions and consumer leases in an amount up to $50,000 (adjusted annually to reflect inflation beginning in 2012). Currently, TILA covers consumer credit transactions in an amount up to $25,000.

5. **Small Business Data Collection**

ECOA is amended to require creditors, in connection with an application for credit for women-owned, minority-owned, or small businesses, to inquire whether the business is a women-owned, minority-owned, or small business, and to maintain a record of the responses received. Creditors are required to compile and maintain this information and submit to the BCFP, who may publicly disclose the aggregate information.

6. **Remittance Transfers**

EFTA is amended to cover remittance transfers (e.g., transfers of funds to a foreign country) and requires several new disclosures in connection with these transfers, including foreign language disclosures. Also, the BCFP is required to issue regulations regarding error resolution procedures, and cancellation and refund policies.

Within two years after the date of the enactment of the Dodd-Frank Act, the Director and the Secretary of Education must submit a report to Congress on private education loans and private educational lenders. At a minimum, the report should address the growth and changes of the private education market, the extent to which parents and students rely on this market to finance post-secondary education, the characteristics of private education loan borrowers, the characteristics of private educational lenders, the underwriting criteria used by such lenders, the consumer protections available to borrowers, and the terms, conditions, and pricing of private education loans.

8. **Reforming the Housing Finance System**

The Secretary must conduct a study of, and develop recommendations regarding, the options for ending the conservatorship of Fannie Mae and Freddie Mac, and submit a report to Congress no later than January 31, 2011.

N. **Financial Fraud**

The US Sentencing Commission is required to review the sentencing guidelines and policy statements applicable to securities fraud, fraud offenses related to financial institutions, federally related mortgage loans, and any other similar provision of law and, if appropriate, amend the federal sentencing guidelines or policy statements. In addition, the Dodd-Frank Act amends the federal securities laws to extend the statute of limitations for certain securities fraud violations to six years.

O. **Transfer of Personnel, Authority, and Functions**

In order to populate and start-up the BCFP, and consistent with its contemplated role as the lead federal consumer protection agency over financial matters, the Dodd-Frank Act provides for the transfer of certain functions, authority, and certain personnel from the federal bank regulatory agencies, FTC, HUD and other federal agencies. There are detailed provisions regarding the transfer of the employees from these other federal agencies, including compensation, seniority, benefits, and other employment-related issues.

P. **Designated Transfer Date; Effective Dates**

Within 60 days of the enactment date of the Dodd-Frank Act, the Secretary must consult with the other appropriate federal agencies and publish notice in the Federal Register of the designated transfer date of personnel, authority, and functions to the BCFP.
(“Designated Transfer Date”). The Designated Transfer Date can be no earlier than 180 days, nor later than 12 months after the date of enactment of the Dodd-Frank Act, unless the Secretary makes a written determination that additional time is required to complete an orderly transition. Any extended date, however, may not be later than 18 months after the date of enactment of the Dodd-Frank Act.

The effective dates for the various subtitles within Title X are generally tied to the Designated Transfer Date. For example, the preemption, visitorial and enforcement provisions are effective as of the Designated Transfer Date, whereas the provisions establishing the BCFP are effective upon the date of enactment of the Dodd-Frank Act.
TITLE XI – FEDERAL RESERVE SYSTEM PROVISIONS

A. Summary

Title XI of the Dodd-Frank Act, a short but controversial Title, makes several important changes to the lending and governance authority of the Federal Reserve System and the participating Federal Reserve Banks under the FRA, as well as changes to the FDIC’s authority to provide financial support to the insured depository institution system. Probably the most important changes made by this Title are changes to the Federal Reserve System’s emergency lending authority under Section 13(3). This is the emergency lending authority that was used by the FRB to provide emergency financial assistance to firms like AIG during the financial crisis, but Title XI carves back this lending authority to prohibit the Federal Reserve System from providing emergency financial support to individual institutions. In a parallel vein, Title XI also creates a mechanism for increased interagency consultation with the FRB and Treasury before the FDIC exercises its statutory authority to provide liquidity to the banking system during times of financial distress.

In a move that created substantial controversy during the Congressional legislative process, however, Title XI also confers on the GAO the authority to audit certain of the Federal Reserve System’s emergency credit facilities, and creates a mechanism for greater transparency and public access to Federal Reserve System information about its credit facilities and financial statements. Finally, Title XI makes changes to how Federal Reserve Bank directors are elected by eliminating the right of Federal Reserve Bank directors who are bank representatives to cast their votes on director election matters, and creates the position of Vice Chairman for Supervision at the FRB governor level.

Title XI becomes generally effective upon the Dodd-Frank Act’s enactment.

B. Changes to the FRB’s Emergency Lending Authority

Section 13(3) of the FRA currently allows the FRB to provide emergency lending assistance to “any individual, partnership or corporation.” This lending authority was used by the FRB in the fall of 2008 to provide emergency financial assistance to individual financial services firms. Title XI (Section 1101) substantially limits the authority to provide financial assistance to individual firms, by conditioning the provision of such assistance to a “participant in any program or facility with broad-based eligibility.”
In turn, the FRB is directed to establish by regulation, in consultation with Treasury, policies and procedures for emergency lending programs and facilities under Section 13(3) (Section 13(3) facility) as soon as practicable after the date of the Dodd-Frank Act’s enactment. These policies and procedures must ensure that any Section 13(3) facility: (i) is for the purpose of providing liquidity to the financial system and not to aid a “failing financial company;” (ii) contains sufficient collateral security provisions to “protect taxpayers from loss;” and (iii) assures the “timely and orderly” termination of the facility. “Insolvent” borrowers would also be prohibited from participation in Section 13(3) facilities. In addition, no Section 13(3) facility could be established to remove assets from the balance sheet of a “single and specific” company, or with the purpose of enabling any “single and specific” company to avoid bankruptcy or insolvency.

Further, the FRB would be required to obtain advance Treasury approval to establish a Section 13(3) facility, and also would be required to report to Congress on an expedited basis on the authorization of any loan or financial assistance and the justifications for the exercise of its authority, plus periodic written updates on any assistance provided. Certain identifying and financial information, however, could be provided on a requested confidential basis.

Finally, if a loan or other assistance under a Section 13(3) facility is outstanding to a financial company at the time it becomes subject to orderly resolution under Title II, any “net realized loss” on such loan by a Federal Reserve Bank would be given the same priority in a US Bankruptcy Code proceeding as that given to a claim by the Treasury under Section 210(b) of the Dodd-Frank Act (orderly liquidation provision relating to priority of claims against the FDIC in insolvency proceedings).

Plainly stated, Title XI’s limitations on the FRB’s use of its Section 13(3) authority are part of the Dodd-Frank Act’s overall effort to eliminate “too big to fail” support for individual financial institutions. Broad-based Section 13(3) facilities of the sort the FRB created during the financial crisis (e.g., the Term Asset-Backed Securities Loan Facility, or TALF) would be permitted, albeit subject to somewhat stricter limits on their creation and use. Further, Title XI does continue to allow for continued emergency financial support for individual financial institutions as part of a broad-based Section 13(3) facility. Whether this emergency lending authority carve-back is a distinction without a difference will remain to be seen.

C. FDIC Liquidity Programs

Three sections of Title XI (Sections 1104, 1105, and 1106) collectively recodify and circumscribe the authority of the FDIC to provide general liquidity to insured depository institutions in times of financial distress, and in certain respects parallel the changes made to the FRB’s emergency lending authority. This authority would be substituted for the FDIC’s current emergency liquidity authority under Section 13(c)(4)(G)(i) of the FDIA, which would be terminated upon the Dodd-Frank Act’s effective date.
At the request of the Secretary (or arguably even in the absence of the Secretary’s request), the FRB and FDIC, upon a two-thirds vote of each body and with the Secretary’s written consent (the latter in consultation with the President), may jointly determine that a “liquidity event” exists and that failure to act would have “serious adverse effects on financial stability or economic conditions” in the United States, and further, that emergency financial stabilization action is needed to “avoid or mitigate” adverse effects on the US financial system or economic conditions (Section 1104 determination). A “liquidity event” is defined as (i) “an exceptional and broad reduction” in the general ability of financial markets participants to sell financial assets without an “unusual and significant discount” or borrow using financial assets without an “unusual and significant” increase in margin, or (ii) an “unusual and significant reduction” in the ability of financial markets participants to obtain unsecured credit.

Upon a Section 1104 determination, the FDIC must create a “widely available program to guarantee obligations of solvent insured depository institutions or solvent depository institution holding companies” during times of severe economic distress, other than the provision of any form of equity (Section 1105 program). Title XI further creates a process that: (i) requires the FDIC, in consultation with the Secretary, to establish policies and procedures for Section 1105 programs; (ii) requires the Secretary, in consultation with the President – and not the FDIC – to establish maximum guaranteed amounts; (iii) requires Congressional approval by joint resolution prior to the exercise of FDIC guarantee authority under a Section 1105 program pursuant to “fast track” legislative procedures; (iv) directs the FDIC to charge fees and assessments, including backup special assessments, to Section 1105 program participants as necessary to cover Section 1105 program funding, administrative and borrowing costs; and (v) allows the FDIC to borrow funds from, or issue obligations to, the Treasury for purposes of implementing a Section 1105 program. The FDIC, however, is prohibited from borrowing funds from the Deposit Insurance Fund established under the FDIA.

Finally, a participating insured bank default on a Section 1105 guarantee, or default on any obligation guaranteed under the FDIC’s legacy Temporary Liquidity Guarantee Program after the Dodd-Frank Act’s enactment, would be mandatory grounds for the FDIC’s appointment as receiver of the defaulting bank. In the case of a defaulting holding company, Title XI would require consideration of whether to institute Title II orderly resolution proceedings, and the filing of a voluntary or involuntary petition under the US Bankruptcy Code (Section 1106)(unless Title II proceedings were in fact commenced).

### D. Audits of Special Federal Reserve System Credit Facilities

Title XI, Section 1102, allows the GAO to audit, including through onsite examinations, any Federal Reserve System Section 13(3) facility, or open market transaction or discount window loan or advance (covered transaction), “solely” for the purposes of assessing the...
facility or covered transaction’s operational integrity, the effectiveness of its security and collateral policies, whether the facility or covered transaction “inappropriately” favors a specific participant or eligible institution, and the policy governing relationships with third party contractors relating to any facility or covered transaction. Section 1102 also requires the GAO to report on its activities and audits, albeit with certain disclosure protections in the form of delayed releases of required reports and information and the temporary redaction of certain participant identifying information (with the conspicuous exclusion of the Section 13(3) facilities established by the Federal Reserve Bank of New York in 2008 to facilitate JP Morgan Chase’s acquisition of the Bear Stearns Companies, and provide financial assistance to American International Group).

In a similar vein, Title XI (Section 1103) provides for public access to GAO Section 13(3) facility and covered transaction audits, FRB financial statements, selected GAO reports to Congress, and “such other information as the [FRB] believes is necessary or helpful” in understanding the accounting, financial reporting, and internal controls of the FRB and the Federal Reserve Banks. This public access is to be provided through a dedicated “audit” web link and webpage on the FRB’s home Internet web site. In addition, Section 1103 provides for the release, albeit on a general delayed (one year plus) release basis, by the FRB of identifying participant and financial information on any Section 13(3) facility or covered transaction.

Further, Section 1109 would direct the GAO to conduct a one-time audit of all Section 13(3) facilities provided from December 1, 2007, up to the date of the Dodd-Frank Act’s enactment. Similar to the audit functions specified in Section 1103, the GAO would be required to assess these facilities’ operational integrity, the effectiveness of their security and collateral policies, whether a facility “inappropriately” favors a specific participant or eligible institution, and the policy governing relationships with third party contractors relating to any facility, as well as whether there were any conflicts of interest in how the facility was established or operated. A report to Congress within one year of the Dodd-Frank Act’s enactment would be required. In addition, the FRB would be required to post on its website by December 1, 2010, designated information on these legacy Section 13(3) facilities.

The GAO also is directed to conduct an audit within one year of the Dodd-Frank Act’s enactment of the Federal Reserve Bank governance process with respect to diversity of representation conflicts of interest, and the operations of Section 13(3) facilities administered through a Reserve Bank, as well as recommend changes to the selection of Federal Reserve Bank directors or other changes in FRB governance processes, as appropriate. The result of this latter examination would be delivered to selected Senate and House leaders.

The authority under Sections 1102, 1103, and 1109 in substantial part represents the outcome, and a compromise, of a contentious debate during the legislative deliberation process over the question of permitting more general GAO audits of the Federal Reserve
Certain Congressional representatives forcefully advocated legislation that would permit a full GAO audit of Federal Reserve System activities and operations, a position that was ardently opposed by other representatives – and the FRB – as an unacceptable infringement on the Federal Reserve System’s independence. In addition, the GAO audit provisions pertaining to existing and new Section 13(3) facilities were designed to address concerns expressed during the deliberative process about the lack of transparency and possible conflicts of interest in the administration of legacy emergency assistance programs during the past financial crisis.

### E. Changes to Federal Reserve Bank Governance and Supervision Policy

Title XI (Sections 1107 and 1108) makes three changes to Federal Reserve System governance and supervision policy matters:

- The president of each Federal Reserve Bank will be elected only by the Class B and Class C directors of that Bank with the approval of the FRB. Class A directors (representatives of member banks supervised by the Reserve Bank) no longer will be eligible to vote on the selection of a Federal Reserve Bank president (Section 1107).
- At the FRB governor level, the position of Vice Chairman for Supervision, to be appointed by the President, has been created. The Vice Chairman for Supervision is tasked with developing policy recommendations for the supervision and regulation of FRB-supervised banks, holding companies and systemically important nonbank financial firms, and overseeing the supervision and regulation of these firms (Section 1108). This person also will be required to appear semi-annually before the SBC and HFSC on supervision and regulatory activities of the FRB.
- Finally, Title XI expressly states that the FRB may not delegate supervisory or regulatory policy to any Federal Reserve Bank.

The governance changes made by Title XI are designed to (i) enhance the independence of the Federal Reserve Banks from the influence of its regulated banking firm constituents, and (ii) enhance and consolidate the profile, authority and control of bank supervision and regulatory policy matters at the FRB level. These changes, in fact, were less than those previously sought in the original Senate-passed bill, which among other things would have prohibited past or present banking officials from serving as Federal Reserve Bank directors altogether.
TITLEx XII – IMPROVING ACCESS TO MAINSTREAM FINANCIAL INSTITUTIONS

A. Summary

Title XII of the Dodd-Frank Act authorizes the Secretary to establish multiyear programs to assist low- and moderate-income individuals, minorities, and underserved families in obtaining access to low-cost banking products, services and financial advice through a series of grants, cooperative agreements, financial agency agreements, and similar contracts with federally insured depository institutions, charitable organizations, and CDFIs. The Secretary is also authorized to promulgate regulations as necessary to implement the requirements of Title XII, and the Secretary is appropriated funds to administer and fund the programs established under Title XII.

In general, the programs established by the Secretary focus on two things:

- enabling low- and moderate-income individuals to establish accounts (including deposit accounts, savings accounts, and closed-end loans) at federally insured depository institutions that are appropriate to the financial needs of the individual and offered on terms that are “reasonable” for them
  - Entities that participate in these programs may, but are not required to, provide individuals with other products or services relating to their accounts, such as small-dollar loans and financial education and counseling.

- providing low-cost, small loans to low- and moderate-income consumers as an alternative to high-cost “small dollar loans,” such as payday loans
  - Such loans must be made on terms that are “reasonable” for consumers and in accordance with lending practices that are “reasonable.”
  - Entities that receive grants from Treasury for small loan programs must take steps to ensure the financial literacy of the loan recipients, such as providing them with counseling and educational opportunities.
B. **Limited Treasury Assistance to Establish a Loan Loss Reserve Fund to Defray the Costs of Operating Small-Dollar Loan Programs**

To mitigate losses arising from and/or defray the costs of small dollar loan programs offered by CDFIs and federally insured depository institutions with a primary mission to serve targeted investment areas, Title XII of the Dodd-Frank Act amends the Community Development Banking and Financial Institutions Act of 1994 to authorize the CDFI Fund (established by that Act) to make grants to the aforesaid institutions for purposes of establishing a loan loss reserve fund. To receive funds from the CDFI Fund, those institutions must agree to provide non-federal matching funds in an amount equal to 50 percent of the amount of any grant received. Funds granted by the CDFI Fund may not be used to provide loans directly to consumers.
TITLE XIII – PAY IT BACK ACT

A. Summary

Title XIII of the Dodd-Frank Act contains a number of changes to existing programs that are intended to reduce the deficit and, in the case of certain changes to TARP, offset the cost of the Dodd-Frank Act.

B. Amendment to Reduce TARP Authorization

The amount authorized under TARP is reduced from $700 billion to $475 billion and Treasury is prohibited from initiating any new programs under TARP after June 25, 2010. Treasury is also prohibited from using repaid TARP funds to reduce the amount of funds outstanding and thereby have additional funds available for existing programs. In other words, if Treasury currently has $175 billion in unallocated TARP funds remaining from the $475 billion now authorized and it receives a repayment of $25 billion, it is not permitted to add those funds to the $175 billion it has available and thereby increase the balance to $200 billion. Those recouped funds are no longer permitted to be recycled and made available to fund existing programs – such as an additional payment to an entity already receiving support.

Treasury is also required to report to Congress every six months on amounts it receives from the sale of troubled assets purchased pursuant to EESA.

C. Deficit Reduction Provisions

Title XIII requires certain funds received by the Treasury to be used for deficit reduction and not as offsets for other spending increases or revenue reductions. Those funds include:

- any funds received from the sale of Fannie Mae, Freddie Mac, or FHLB obligations;
- any fees or assessments received from Fannie Mae, Freddie Mac, or the FHLBs in connection with preferred stock purchase agreements, mortgage-backed security purchase programs, or any other program authorized under Section 1117 of HERA;
- any funds authorized to a state pursuant to ARRA that are not accepted by a state Governor or state legislature;
- any funds accepted by a state or local government under ARRA that have not been used and which have been “recaptured” by a federal agency; and
• subject to Presidential waiver authority, any funds appropriated under ARRA that have not been obligated as of December 31, 2012.

D. Federal Housing Finance Agency Report

The Director of the FHFA is required to submit a report to Congress on FHFA’s plans to continue supporting and maintaining the US housing industry, while at the same time guaranteeing that taxpayers will not suffer unnecessary losses.
TITLE XIV – MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT

A. Summary

Title XIV, the Mortgage Act, is intended to address a number of the residential mortgage lending problems highlighted by the subprime lending crisis; however, its scope is not limited to subprime or adjustable rate mortgage loans alone. In many instances, the Mortgage Act applies these new requirements across a broad spectrum of mortgage loans and mortgage-related products and services and places new compliance burdens on the entire mortgage industry. In other instances, the provisions are limited to three narrower classes of mortgage loans: higher-risk mortgage loans, qualified mortgage loans, and high-cost mortgage loans. The Mortgage Act will have a significant impact on the existing brokering, origination, and servicing practices in the residential mortgage lending area by, amongst other things, requiring lenders to ensure a borrower’s ability to repay a mortgage loan, prohibiting certain lending practices, limiting YSPs paid to mortgage originators, expanding the scope of regulations that apply to “high-cost” mortgage loans, requiring various additional mortgage-related disclosures, limiting certain prepayment penalties, and imposing tougher restrictions on property appraisals.

The Mortgage Act generally includes much of the text of HR 1728, which the House passed in May 2009, and which was subsequently included in the Dodd-Frank Act. Although the Senate’s reform legislation did not have a separate title covering residential mortgage lending, several mortgage-related provisions were included in the consumer financial protection provisions of the original senate-passed bill. The merging of these provisions resulted in what the Conference Committee approved as Title XIV.

B. Origination Standards for Mortgage Loans

The Mortgage Act establishes certain origination standards to be applied by lenders in the underwriting for residential mortgage loans. These standards are intended to address some of the underwriting concerns exposed by the subprime lending crisis, including inadequate supervision of mortgage originators, in particular, the steering of consumers into mortgage loan products that generated higher fees for the lender, and the inability of borrowers to repay their mortgage loans.

1. Duty of Care

In addition to the duties imposed by other consumer protection laws, each mortgage originator (broadly defined by the Mortgage Act to include any person
who takes an application for a mortgage loan, offers or negotiates the terms of a mortgage loan, or assists a consumer in obtaining or applying for a mortgage loan, but excludes creditors (other than those table funding) must be registered and licensed as a mortgage loan originator in accordance with applicable state and federal laws, including the SAFE Act, and include any unique identification number issued by the Nationwide Mortgage Licensing System and Registry on all loan documents. A broader duty of care imposed upon mortgage originators by the original House-passed bill was not included in the Dodd-Frank Act.

2. **Prohibition on Steering and Certain Mortgage Originator Compensation**

No mortgage originator can receive from any person, and no person can pay a mortgage originator, any direct or indirect compensation that varies based upon the terms of the loan (other than the principal amount). With certain exceptions noted below, this provision also prohibits a mortgage originator from receiving compensation from any person other than the consumer, who knows that the consumer is directly compensating the mortgage originator, from paying a mortgage originator any fee or charge other than *bona fide* third party charges not retained by the mortgage originator, creditor, or affiliate of either the mortgage originator or the creditor. This provision does not prohibit a person other than the consumer from paying an origination fee, if the mortgage originator does not receive any compensation from the consumer, and the consumer does not pay discount points, origination points, or similar fees.

While not expressly mentioning YSPs, this provision is intended to preclude the payment of YSPs and similar compensation, where the mortgage originator is likely to steer a borrower to a particular loan because he or she receives additional compensation from the lender based upon the borrower’s rate of interest.

3. **Rulemaking**

The Mortgage Act requires the issuance of numerous regulations under TILA by the BCFP, including those that would prohibit:

- mortgage originators from steering any consumer to a residential mortgage loan (i) when consumer lacks the reasonable ability to pay, or (ii) that has predatory characteristics or effects (e.g., equity stripping, excessive fees, or abusive terms);
- mortgage originators from steering a consumer from a qualified mortgage to a non-qualified mortgage loan where the consumer qualifies for a qualified mortgage;
• abusive or unfair lending practices that promote disparities of consumers of equal creditworthiness but of different race, gender, age or ethnicity; and
• mortgage originators from (i) mischaracterizing the credit history of a consumer or the loans available to a consumer, (ii) mischaracterizing the appraised value of the property securing the loan, or (iii) if unable to suggest, offer, or recommend to a consumer a loan that is not more expensive than the loan for which the consumer qualifies, discouraging a consumer from seeking a loan from another mortgage originator.

4. Rules of Construction

While prohibiting YSPs and similar compensation that would vary the compensation from all sources to a mortgage originator based upon the terms of the loan, this provision does not restrict (i) the compensation paid to a creditor by a secondary market participant in connection with the secondary market sale of the mortgage loan (but not a table-funded transaction); (ii) a consumer’s ability to finance any origination fees or costs as long as those fees do not vary based upon the terms of the loan or the consumer’s decision to finance the fees; and (iii) incentive payments to a mortgage originator based upon the number of loans originated within a specified period of time.

C. Ability to Repay

No creditor may make a residential mortgage loan without making a reasonable and good faith determination that the consumer has the reasonable ability to repay the loan. This determination should consider credit history, income, expected income, debt-to-income ratio, employment status, and other financial resources. In the underwriting documentation, a creditor must verify the income that it relies on to determine the borrower’s repayment ability. As part of a streamlined refinancing that applies to a certain government insured loan program, HUD, VA, Department of Agriculture and the Rural Housing Service may exempt refinancings under a streamlined financing from the income verification requirements as long as certain conditions are satisfied.

1. Nontraditional Mortgage Loans

For variable rate loans that defer principal or interest and interest-only and negative amortization loans, the creditor must verify the borrower’s ability through final maturity under various amortization scenarios, including the increased balance that may accrue from any negative amortization provision. The process for calculating the monthly payment and permissible assumptions are set forth in the Mortgage Act. Reverse mortgages and certain bridge loans are not required to be subject to this type of analysis.
2. **Qualified Mortgages**

A creditor and any assignee may presume that a loan meets the ability to pay standards if it is a “qualified mortgage.”

- The Mortgage Act contains a detailed definition of “qualified mortgage” and provides the BCFP with the authority to expand, contract or amend the statutory definition. Except as noted below, this definition would generally include a fixed rate conventional mortgage loan with total points and fees of three percent or less where the borrower meets certain guidelines to be set forth in regulations established by the BCFP relating to debt-to-income ratio. HUD, VA, Department of Agriculture and the Rural Housing Service, in consultation with the BCFP, may prescribe rules defining qualified mortgage for purposes of the loans that they guarantee, insure, and administer.

- A qualified mortgage could also include an adjustable rate mortgage loan if the loan underwriting is based on the maximum rate permitted during the first five years and the payment schedule fully amortizes the loan by the final maturity date. The BCFP also has the ability to include mortgage loans with balloon payments if certain conditions are met.

- The definition of a qualified mortgage is important for two reasons. First, qualified mortgages are presumed to meet the ability to repay standard, thus the lender does not need to verify the borrower’s ability to repay. Second, it indirectly determines the scope of the exemption from the risk retention requirements applicable to securitizations involving “qualified residential mortgages” (as discussed in Title IX). The definition of “qualified residential mortgage” in the risk retention exemption cannot be broader than the definition of “qualified mortgage” in TILA.

D. **New TILA Liability and Enforcement Provisions**

1. **Creditors and Assignees**

Creditors who violate the ability to repay or anti-steering /compensation provisions can be liable for all interest and fees paid by the borrower as well as actual and statutory damages. Furthermore, for purposes of these two types of violations, the borrower may assert as a defense by recoupment or set off without regard to any statute of limitation in any foreclosure action initiated by or on behalf of the creditor, assignee or any holder of the mortgage. The statutory damages available for certain violations are increased from $100-$1,000 to $200-$2,000.
2. **Mortgage Originators**

Mortgage originators (brokers, loan officers, and others involved in the origination process) who violate the requirements of Section 129B of TILA (duty of care standard or the anti-steering/compensation provisions) are liable for up to three times the total amount of compensation received plus reasonable attorneys’ fees, and the costs incurred by the consumer in bringing the action.

3. **Statute of Limitations**

For violations of Section 129, 12B and 129C of TILA (high-cost mortgage, anti-steering/compensation, and ability to repay provisions), the period of time for bringing a claim is increased from one year to three years from the date of the occurrence.

4. **State Attorney General Enforcement Authority**

The ability of State AGs to bring enforcement actions under TILA is expanded to include Sections 129B-129H (the duty of care, anti-steering, ability to repay, escrow requirements, appraisal independence, prompt crediting requirements, pay-off statements, and property appraisal requirements for higher-risk mortgages). Currently, State AGs only are able to bring enforcement actions for violations of Section 129 (the high-cost mortgage provisions).

5. **Borrowers**

In addition to any other remedy available under applicable law, no creditor or assignee is liable to any borrower under TILA if such borrower or any co-borrower has been convicted of obtaining a mortgage loan by fraud.

E. **Additional Restrictions and Disclosures**

The Mortgage Act establishes the following additional restrictions, requirements and disclosures in connection with certain mortgage loans:

- phased-out prepayment penalties on qualified mortgages (first year – three percent, second year – two percent, third year – one percent);
- prohibition on prepayment penalties for non-qualified mortgages;
- creditors prohibited from offering a mortgage with a prepayment penalty unless they offer a loan option that does not impose such a penalty;
- prohibition on the financing of single premium credit insurance or any payments associated with any debt collection or repayment suspension agreement (except that certain fees paid on a monthly basis should not be considered financed);
• no open- or closed-end mortgage loan may have a provision requiring mandatory arbitration as the method for resolving any controversy or settling any claims arising out of the transaction;
• negative amortization is not permitted unless certain disclosures are provided prior to consummation and the consumer receives any required homeownership counseling (first-time borrower);
• notice describing the protection of state anti-deficiency law and the significance for the consumer of the loss of such protection;
• notice of whether the creditor accepts partial payments, and how such payments (if accepted) will be applied;
• notice six months before the reset date of a hybrid adjustable rate mortgage that describes, the index or formula used, a good faith estimate of the resulting adjusted monthly payment, and a list of alternatives that the consumer may pursue prior to the adjustment date; and
• creditor, servicer or assignee must provide a periodic statement for each billing cycle containing certain information about the residential mortgage loan, including principal amount, current interest rate, contact information to obtain information about the mortgage, and the contact information for counseling programs.

F. High-Cost Mortgage Loans

1. Coverage

The definition of “high-cost mortgage” is expanded to cover a broader range of loans by lowering the reference interest rate, as well as the points and fees triggers, and adding a third trigger covering prepayment penalties.

• In the case of a first mortgage loan, the APR trigger at consummation is met if the rate is more than 6.5 percentage points above the average prime offer rate (as published by the BCFP) for a comparable transaction or, in the case of a junior mortgage, more than 8.5 percentage points above the average prime offer rate for a comparable transaction. The BCFP has the authority to increase or decrease the APR triggers.
• For transactions of $20,000 or more, the points and fees trigger is set at five percent of the total transaction amount and for smaller transactions, the lesser of eight percent of the total transaction amount or $1,000. Furthermore, the definition of points and fees is expanded to include all compensation paid directly or indirectly to a mortgage originator and certain other fees currently excluded.
• A third trigger is added which will cover loans where the transaction documents permit the creditor to charge or collect a prepayment penalty more than 36 months after the closing date or such penalty exceeds, in the aggregate, more than two percent of the prepaid amount.
2. **New Prohibitions**

Enhances existing protections regarding prepayment penalties and balloon payments and prohibits the following practices:

- recommending or encouraging a borrower to default on an existing loan in connection with a high-cost loan refinancing;
- imposing late fees in excess of four percent of the payment amount or fees imposed within 15-days of the due date;
- acceleration of debt (except for payment default, due-on-sale, or other material violation of loan agreement);
- financing prepayment penalty fees in connection with refinancing if creditor or an affiliate of the creditor is the noteholder of the note being refinanced;
- financing any points or fees;
- structuring transaction to avoid coverage;
- charging fees to modify or defer any payment;
- charging fees for payoff statement fees; and
- making such loans without required pre-loan counseling.

3. **Correction of Errors**

A creditor or assignee is not liable for any violation if it discovers the error that constitutes a violation of high-cost loan provisions within 30 days of closing and either (i) makes the necessary adjustments to the loan to satisfy the requirements, or (ii) changes the terms of the loan in a manner beneficial to the consumer so that loan is not a high-cost mortgage loan. A similar correction process is also available within 60 days of a creditor’s discovery of any unintentional violation or *bona fide* error.

G. **Office of Housing Counseling**

The Mortgage Act establishes an office of housing counseling within HUD. This office will be headed by a director appointed by the Secretary of HUD, and its primary function will be to develop and expand homeownership and rental housing counseling, and to publicize the availability of these services through a public service multimedia awareness campaign.
H. Residential Mortgage Servicing Practices

1. Escrow or Impound Accounts

The establishment of escrow or impound accounts for the payment of taxes and insurance will be required in connection with certain first lien mortgage loans, including:

- loans made, insured, or guaranteed by a state or federal government;
- where required by state law;
- loans where the principal balance does not exceed the conforming loan limit and the APR exceeds the average prime offer rate by 1.5 percent; and
- loans where the principal balance exceeds the conforming loan limit and the APR exceeds the average prime offer rate by 2.5 percent.

The regulations may exclude certain types of creditors from this requirement.

2. Servicer Restrictions

TILA and RESPA are amended to provide that a servicer may not:

- force-place insurance, unless there is a reasonable belief that the borrower has failed to comply with a contract’s requirement to maintain insurance;
- charge a fee for responding to a valid qualified written request;
- fail to take timely action to respond to borrower’s request to correct errors related to payment, payoff amounts, or avoiding foreclosure;
- fail to respond within ten business days of a request from a borrower to provide contact information about the owner or assignee of loan;
- fail to comply with any other obligation imposed by HUD; or
- fail to return an escrow balance or provide a credit within 20 business days of a loan being paid off.

3. Qualified Written Requests

A servicer must acknowledge receipt of a qualified written request under RESPA within five business days (reduced from the current 20 business days requirement) and provide a final response within 30 business days (reduced from the current 60 business day requirement). A 15 business day extension is permitted if the borrower is notified of the extension before the end of the period and the reason for the delay.
4. **Crediting Consumer Payments**

   A servicer must promptly credit mortgage payments received from a borrower on the date of receipt except where payment does not conform to previously established requirements.

5. **Payoff Amounts**

   A servicer or creditor must send an accurate payoff statement within a reasonable period of time but in no case more than seven business days after receipt of a written request from the borrower.

I. **Appraisals**

   The Mortgage Act contains detailed provisions regarding appraisals in connection with residential mortgage loans. These provisions are intended to address concerns about the quality of appraisals and appraiser independence.

1. **Higher-Risk Mortgage Loans**

   A creditor may not make a higher-risk mortgage loan without first obtaining a written appraisal of the property performed by a certified or licensed appraiser who conducts a physical inspection of the interior of the property and obtains a second appraisal if the property was previously purchased within 180 days. A higher-risk mortgage is defined to include first and subordinate lien mortgage loans where the APR exceeds the average prime offer rate by a certain percentage based upon the principal amount of the loan.

2. **GAO Study on Appraisals and HVCC**

   The GAO is required to conduct a study covering various appraisal-related matters, including (i) the effectiveness and impact of – (A) appraisal methods, (B) appraisal valuation models, and (C) appraisal distribution channels, (ii) the HVCC, and (iii) the FFIEC appraisal subcommittee’s function. No later than 12 months after the enactment of the Mortgage Act, the GAO shall submit its findings to Congress. Prior to submitting the final results of its study, the GAO is required to provide a status update and any preliminary findings to Congress no later than 90 days after the date of enactment. The results pertaining to the study of the FFIEC’s appraisal subcommittee’s functions must be provided to Congress no later than 18 months after the date of enactment.
3. **Appraisal Independence**

Amends TILA to prohibit acts or practices that violate appraisal independence. For purposes of this provision, an act or practice that violates appraisal independence includes:

- an appraisal conducted by a person with an interest in the underlying transaction;
- mischaracterizing the appraised value of the property;
- seeking to influence the appraiser or encouraging a targeted value; and
- withholding or threatening to withhold payment for an appraisal report when performed in accordance with the contract.

While the federal banking agencies, the FHFA, and the BCFP, are authorized to jointly issue regulations with respect to acts or practices that violate appraisal independence for consumer credit transactions secured by a lien on the principal dwelling of the consumer, the FRB is required to issue interim final regulations no later than 90 days after the date of enactment of the Dodd-Frank Act defining with specificity acts or practices that violate appraisal independence. Upon publication of these interim final regulations, the HVCC is repealed.

4. **Mortgage Loan Modifications**

The Mortgage Act requires several changes to the HAMP. These changes will:

- prohibit persons convicted of certain crimes within the past ten years from receiving assistance under HAMP and other mortgage assistance programs authorized or funded by EESA;
- require each mortgage servicer participating in HAMP to provide a borrower whose modification request is denied with all borrower-related and mortgage-related input data that was used in the net present valuation analyses that were performed in connection with the borrower’s request;
- require the Secretary to establish and maintain a web site that allows borrowers to perform a net present value analysis regarding their mortgage loan and determine whether their mortgage would be accepted or rejected for modification under HAMP.

J. **Mortgage Assistance Programs**

The Mortgage Act allocates additional funds for emergency mortgage relief and neighborhood stabilization programs. These allocations would include (i) effective, October 1, 2010, $1 billion to HUD to establish an emergency mortgage relief fund for certain borrowers, and (ii) an additional $1 billion to states and local governments for...
redevelopment of abandoned and foreclosed homes. In addition, HUD is allocated $35 million for fiscal years 2011 and 2012 to establish a program for making grants and providing a full range of foreclosure legal assistance to low- and moderate-income homeowners and tenants. Legal assistance funds provided under this program must be used for mortgaged-related default, foreclosure, or eviction proceedings and not to support any class action litigation.

K. Effective Dates

The Mortgage Act requires numerous rulemakings under TILA prior to the statutory provisions becoming effective. The final regulations implementing the Mortgage Act must be completed by the end of the 18 month period beginning on the Designated Transfer Date (as defined in Title X; see Title X summary) and become effective not later than 12 months after they are issued in final form. To the extent that regulations required by the Mortgage Act are not issued within 18 months of the Designated Transfer Date, the provisions of the Mortgage Act will take effect on such date. The implementation date for the required regulations is designed to accommodate establishment of the BCFP and the transfer of rulemaking authority from the FRB to the BCFP.
TITLE XV – MISCELLANEOUS PROVISIONS

A. Summary

Title XV of the Dodd-Frank Act contains a number of provisions that, with one exception (a study on core deposits) address issues unrelated to financial reform, such as (i) restrictions on the use of US funds by the IMF; (ii) transparency and foreign corruption in underdeveloped countries with large extractive industries (e.g., oil, natural gas, and minerals); and (iii) industrial use of minerals that originate in conflict regions, specifically the Democratic Republic of the Congo (DRC).

B. Restrictions on Use of United States Funds for Foreign Governments; Protection of American Taxpayers

The Dodd-Frank Act requires the Secretary to instruct the US Executive Director at the IMF to evaluate loan proposals to countries where the amount of the country’s public debt exceeds the country’s GDP in the most recent year in which data is available, and also to determine whether the country is eligible for assistance from the International Development Association. The US Executive Director is required to consider these issues and review the proposal before it is submitted to the Board of Executive Directors of the IMF, and must oppose the granting of any loan that is unlikely to be repaid in full. The Secretary is required to report annually to the HFSC and SBC on loan grants made by the IMF over US objections until the loan is repaid.

C. Conflict Minerals

1. SEC Disclosure

The Dodd-Frank Act amends the Exchange Act to require the SEC to promulgate rules within 270 days of enactment of the Dodd-Frank Act requiring SEC filers to disclose to the SEC whether minerals that are necessary to a product they manufacture originated in the DRC and/or a neighboring country. If the disclosure indicates that such minerals were used, a certified report must also be filed with the SEC and posted on the filer’s website describing:

- the measures taken to exercise due diligence on the source and chain of custody of the minerals, including an independent private sector audit of the report; and
• a description of the products manufactured or contracted to be manufactured that are not “DRC conflict free.”

  • “DRC conflict free” means the product does not contain minerals that directly or indirectly finance or benefit armed groups in the DRC or an adjoining country.

D. Disclosure of Payments by Resource Extractors; Coal Mine Safety Reporting

The Dodd-Frank Act amends the Exchange Act to require the SEC to promulgate rules within 270 days of enactment of the Dodd-Frank Act requiring each issuer engaged in resource extraction to include in its annual report information relating to any payment made by it, any subsidiary, or an entity under its control, to a foreign government or the federal government for the purpose of the commercial development of oil, natural gas, or minerals. To the extent practicable, the SEC is also required to compile this information from the annual reports and make it publicly available.

In addition, public issuers that operate coal or other mines, or that control coal/other mine operators, generally are required to make certain disclosures relating to mine safety violations, citations, patterns of violations, and mine shutdowns in any federal securities law periodic report that is filed on or after the date of the Dodd-Frank Act’s enactment.

E. Studies and Reports

1. Study on Core Deposits

   No later than one year after enactment of the Dodd-Frank Act, the FDIC must submit a report to the HFSC and SBC on the results of a study it is required to conduct on the distinction between “core deposits” and “brokered deposits” and how further distinguishing between the two could affect FDIC insurance premiums, the deposit insurance fund, the general economy and the US banking sector, and competition between large institutions and community banks.

2. Study on Inspector Generals

   No later than one year after enactment of the Dodd-Frank Act, the Comptroller General must issue a report to the SBC, Senate Homeland Security and Government Affairs Committee, HFSC, and House Oversight and Government Reform Committee assessing the relative independence, effectiveness, and expertise of presidentially appointed inspectors general and inspectors general of designated federal entities, and the effects on independence of the amendments to the Inspector General Act of 1978 made by the Dodd-Frank Act.
TITLE XVI – SECTION 1256 CONTRACTS

A. Certain Swaps Not Treated as Section 1256 Contracts

Title XVI of the Dodd-Frank Act amends Section 1256(b) of the Internal Revenue Code, to clarify that Section 1256 does not apply to certain derivative contracts transacted on exchanges.

Thus, any interest rate swap, currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, credit default swap, or similar agreement is not required to be “marked to market.” Further, by not being treated as section 1256 contracts, gain or loss attributable to these derivative contracts are not subject to the characterization rules of Section 1256 (e.g., 40 percent of gain or loss treated as short term capital gain or loss and 60 percent of gain or loss treated as long term capital gain or loss).

This amendment is generally considered beneficial to persons investing in such derivative contracts. But the change makes clear that these contracts are not eligible for the 40 percent short term, 60 percent long term capital gain or loss treatment that applies to Section 1256 contracts. Thus, investors should be able to treat the gain or loss derived from these derivative contacts consistent with the characterization of the underlying investment.
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