**Title I**

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1. Title I – Financial Stability

This Title establishes a new supervisory structure for the risk-based oversight of the U.S. financial system that will focus on:

- Identifying and addressing systemic risks to the stability of the U.S. financial system;
- Bringing nonbank financial companies (companies that are predominantly engaged in financial activities that are not bank holding companies) ("nonbanks") that are determined to be significant to U.S. financial stability under comprehensive financial regulation and supervision; and
- Imposing new and heightened prudential standards for the operation of financial institutions and financial markets in the U.S.

Under this structure, a new entity, the Financial Stability Oversight Council ("Oversight Council"), is created. It is intended to bring together a broad range of financial regulatory agencies in an attempt to ensure that developments or practices anywhere throughout the financial services sector of the economy that might ultimately have a systemic impact are considered and addressed on an inter-agency basis. The Oversight Council is responsible for determining which nonbanks will be subject to comprehensive Federal regulation, and it has significant authority to make recommendations to the Board of Governors of the Federal Reserve System ("Fed") for the implementation of the heightened prudential standards to be applied to bank holding companies ("BHCs") with total consolidated assets of $50 billion or more and designated nonbanks and to make similar recommendations to other financial regulatory agencies.

The Fed is given the principal operational role in carrying out Congress' intention to address systemic risk. The Fed will make determinations on how heightened prudential standards will be implemented and, in some cases, whether particular standards suggested by Congress will be implemented. This will include a new form of prompt corrective action rules at the holding company level. The Fed will have authority to determine how it will conduct its regulation of nonbank companies that are required to register with the Fed because they are considered to have the potential to pose a threat to U.S. financial stability.

More broadly, the Federal financial regulatory agencies, and the Federal banking agencies, in particular, are expected to work together in their roles on the Oversight Council and in other contexts required by Title I to seek to proactively address potential systemic problems, including by strengthening capital requirements to address potential areas of concern.

### 1.1. The Establishment of the Oversight Council

1.1.1. What Entities Are Impacted and How? Title I primarily affects two types of entities, (i) BHCs that have total consolidated assets of $50 billion or more and are closely interconnected with similar companies ("Large BHCs") and (ii) nonbanks that are predominantly engaged in financial activities and whose material financial distress would pose a threat to the stability of the U.S. financial system, as determined by the Oversight Council

(“Significant Nonbanks”). Farm Credit institutions or entities regulated by the Farm Credit Administration are expressly excluded from being treated as a nonbank financial company and thus would not be subject to the provisions of Title I.

A nonbank “predominantly engaged in financial activities” means 85% or more of its gross revenues are derived from activities that are “financial in nature” for purposes of section 4(k) of the Bank Holding Company Act (“BHC Act”) or from ownership or control of depository institutions or 85% or more of its assets are related to such activities or the ownership or control of such institutions. [§102(a)(6)]

The Oversight Council also will create the blueprint for the supervision of Large BHCs and Significant Nonbanks through the recommendations it makes regarding their prudential supervision. However, the supervision of such companies and any enforcement actions will rest with the Fed. The Oversight Council may also make recommendations to financial regulatory agencies in general to address systemic concerns.

1.1.2. <u>What Is the Oversight Council and What Are Its Responsibilities</u>? The Oversight Council is established as of the date of enactment of the Act. Its purposes are to (i) identify risks to U.S. financial stability that could arise from the financial distress or failure of Large BHCs or Significant Nonbanks, (ii) promote market discipline by taking action to dispel expectations that the shareholders, creditors, or counterparties of such companies will be shielded from loss by the government in the event of such companies’ failure, and (iii) respond to emerging threats to U.S. financial stability. [§ 112(a)]

1.1.2.1. <u>Duties</u>. The Oversight Council will perform several duties related to identifying and responding to systemic threats to the U.S. financial system, including the following: (i) direct the information collection and analysis activities of the Office of

Financial Research ("OFR"), a new Treasury Department ("Treasury") agency created by the Act; (ii) monitor the financial services marketplace; (iii) identify regulatory gaps; and (iv) make recommendations regarding new or heightened prudential standards to govern activities or practices that could create or increase risks of contagion. [§ 112(a)]

> The Oversight Council will review and submit comments to the SEC and the Financial Accounting Standards Board ("FASB") on existing and proposed accounting principles, standards, and procedures in order to ensure that accounting rule-making bodies more seriously consider alternatives when developing accounting principles, standards and procedures.

1.1.2.2. <u>Oversight Council Membership and Operations</u>. The Oversight Council consists of ten members: (i) Secretary of the Treasury ("Treasury Secretary"), who serves as chairperson; (ii) Chairman of the Fed; (iii) Comptroller of the Currency ("OCC"); (iv) Chairman of the Federal Deposit Insurance Corporation ("FDIC"); (v) Director of the Bureau of Consumer Financial Protection ("Bureau"); (vi) Chairman of the Securities and Exchange Commission ("SEC"); (vii) Chairperson of the Commodity Futures Trading Commission ("CFTC"); (viii) Director of the Federal Housing Finance Agency; (ix) the Chairman of the National Credit Union Administration; and (x) an individual with insurance industry expertise, appointed by the President to serve a six-year term.

The Director of the OFR serves as a nonvoting advisory member, as will the Director of the Federal Insurance Office, a State insurance commissioner, a State banking supervisor and a State securities commissioner. The FSOC also may appoint special advisory, technical, or professional committees to assist it. The Oversight Council will meet at least quarterly, and additional meetings may be called by the Treasury Secretary or by a majority of the members then serving. The Oversight Council acts by majority vote, except as otherwise provided for specified actions. [§ 111(b) - (f)]

1.1.2.3. Information Gathering by the Oversight Council and the Fed. In order to mitigate the burden of complying with information requests, the Oversight Council, acting through the OFR, is required to coordinate with the primary state or Federal regulatory agency before requiring any Large BHC or Significant Nonbank to submit reports to the Oversight Council, and to rely whenever possible on information available from such agencies or the OFR. Similar consultation with home country supervisors must be undertaken before requiring a foreign BHC or nonbank to submit reports. However, whenever the Oversight Council is unable to determine based on available information whether the financial activities of a nonbank pose a threat to U.S. financial stability, the Oversight Council may request the Fed to conduct an examination of such company for the sole purpose of determining whether the company should be made subject to Fed supervision under the Act. [§ 112(d)]

1.1.3. Treatment of Certain TARP Recipients as Significant Nonbanks. Any company that, as of January 1, 2010, was a BHC with total consolidated assets of $50 billion or more and participated in the Capital Purchase Program established under the Troubled Asset Relief Program ("TARP") authorized by the Emergency Economic Stabilization Act of 2008 and that ceases thereafter to be a BHC, will be treated as a Significant Nonbank regardless of whether a formal determination has been made. An affected company may appeal such treatment to the Oversight Council, which must issue a report on its proposed decision to Congress and then notify the company, which notification includes the basis for its final decision. In making its decision, the Oversight Council must consider whether the company meets the standards to be a Significant Nonbank. [§ 117]

1.1.4. Oversight Council Recommendations to the Fed Regarding Enhanced Supervision and Prudential Standards for Large BHCs and Significant Nonbanks. The Oversight Council may recommend prudential standards and reporting and disclosure standards to the Fed for Large BHCs and Significant Nonbanks for the purpose of preventing or mitigating risks to U.S. financial stability. The Act identifies specific areas for the Oversight Council to consider for potential recommendations: (i) capital requirements, (ii) liquidity requirements, (iii) resolution plans ("living wills"), (iv) credit exposure requirements, (v) concentration limits, (vi) contingent capital requirements, (vii) enhanced public disclosures, (viii) short-term debt limits, and (ix) risk management requirements.

As part of this process, the Oversight Council is directed to conduct a study regarding the establishment of a contingent capital requirement (long-term hybrid debt that is subject to conversion to equity in times of financial stress) for Large BHCs and Significant Nonbanks. The study must be submitted to Congress within two years of enactment of the Act, after which the Oversight Council may make recommendations to the Fed regarding the imposition of contingent capital requirements.

1.1.5. Reporting Requirements. The Oversight Council, acting through the OFR, may require Large BHCs and Significant Nonbanks, and any subsidiary thereof, to submit certified reports regarding their financial condition, risk management systems, transactions with their depository institution subsidiaries, and their potential to disrupt financial markets or affect U.S. financial stability. [§ 116]

1.1.6. Oversight Council Recommendations to Financial Regulatory Agencies Regarding Systemic Concerns. The Oversight Council may issue recommendations to the primary financial regulatory agencies to apply new or heightened standards and safeguards, including any standards proposed for Large BHCs and Significant Nonbanks, to all BHCs and nonbanks within their jurisdiction, if the Oversight Council determines that the conduct of the financial activities or practices in question could create or increase risks of contagion of significant credit, liquidity, or other problems among BHCs, nonbanks, U.S. financial markets, or low-income, minority, or under-served communities. Such standards and safeguards may include prescribing how an activity or practice may be conducted or prohibiting such activity or practice altogether. Before making any recommendation, the Oversight Council must consult with the primary financial regulatory agencies and provide the public with notice and an opportunity for comment. Each primary financial regulatory agency must implement the Oversight Council's recommendation or adopt similar standards deemed acceptable by the Oversight Council, or it must explain in writing to the Oversight Council, not later than 90 days after receiving a recommendation, why it has determined not to follow it. The Oversight Council is required to report to Congress on any such recommendation and its implementation. [§ 120]

1.1.7. Oversight Council Study Regarding the Effects of Size and Complexity of Financial Institutions. The Chairman of the Oversight Council is required to conduct a study of the economic impact of possible financial services regulations intended to reduce systemic risk. The study is to examine the costs and benefits of, among other things, limits on the size of BHCs and other large financial institutions. The Chairman is required to submit a report of any findings and determination made in carrying out the study within 180 day of enactment of the Act and thereafter no less than once every 5 years. [§ 123]

1.2. The Fed's New Authority In Regard to Financial Stability

1.2.1. Fed Required to Adopt Enhanced Supervision and Prudential Standards for Large BHCs and Significant Nonbanks. The Fed is given a broad mandate to establish prudential standards and reporting and disclosure requirements for Large BHCs and Significant Nonbanks. For purposes of this section 1.2., Large BHCs and Significant Nonbanks are referred to as a "Company" or "Companies." These standards may be based on recommendations made by the Oversight Council or based on the Fed's own determination.

Any standards adopted by the Fed must be more stringent than the corresponding standards applicable to BHCs in general and to nonbanks that are not designated as Significant Nonbanks. The standards must become increasingly stringent based on (i) the presence of the same factors used by the Oversight Council to make a determination that a nonbank should be treated as Significant Nonbank; (ii) whether the Company owns an insured depository institution; (iii) the Company's nonfinancial activities and affiliations; and (iv) any other factors the Fed deems appropriate. The Fed is authorized to differentiate among Companies on an individual basis or by category, taking into account, among other things, their capital structure, riskiness and other risk-related factors. For Large BHCs, the Fed may use a higher dollar threshold for applying most of the heightened standards. [§ 165(a)]

The Fed is required to establish standards by regulation or order in particular specified areas. It is also permitted, but not required, to establish standards in other areas, including in several specified areas. When establishing standards applicable to foreign BHCs and foreign Significant Nonbank, the Fed must give due regard to the principle of national treatment and equality of competitive opportunity and take into account the extent to which those companies are subject to comparable home country standards applied on a consolidated basis. [§ 165(b)]

1.2.1.1. Required Standards. The Fed must adopt standards for Companies, by regulation or order, in the following areas.

1.2.1.1.1. Capital. The Fed must adopt standards for risk-based capital and leverage limits. In the case of an individual Company, the Fed, in consultation with the Oversight Council, may determine that stricter capital standards are not required and may instead apply other standards that result in similarly stringent risk controls.

1.2.1.1.2. Liquidity Requirements. The Fed must adopt standards for liquidity requirements.

1.2.1.1.3. Resolution Plan. The Fed must require periodic reports to the Fed, the Oversight Council and the FDIC on Company plans for rapid and orderly resolution in the event of material financial distress or failure. The plan must provide information regarding (i) how any affiliated depository institution is adequately protected from the activities of the nonbank subsidiaries of the Company; (ii) a full description of the ownership structure, assets, liabilities, and contractual obligations of the Company; (iii) an identification of the cross-guaranties tied to different securities, major counterparties, and a process for determining to whom the collateral of the company is pledged; and (iv) any other information the Fed and FDIC jointly require by regulation or order.

If the Fed and the FDIC determine that a resolution plan is not credible or would not facilitate an orderly resolution of the Company under Chapter 11 of the Bankruptcy Code, they are to notify the Company of the deficiencies. The Company must within a specified time resubmit a credible plan that would result in an orderly resolution under Chapter 11, which must include any proposed changes in business operations or corporate structure to facilitate implementation of the plan.

If a Company does not resubmit a credible revised plan on a timely basis, the Fed and the FDIC may jointly impose more stringent capital, leverage or liquidity requirements, or restrictions on growth, activities or operations of the company, or any of its subsidiaries, until the company resubmits an acceptable plan. In the case of a Company that becomes subject to such additional requirements, if it fails to resubmit a credible plan within two years of the imposition of the requirements, the Fed and FDIC in consultation with the Oversight Council may direct the company to divest certain assets or operations identified by the Fed and the FDIC to facilitate an orderly resolution of the Company under Chapter 11. [§ 165(d)]

A resolution plan will not be binding on a bankruptcy court, a receiver appointed under Title II of the Act, or any other authority authorized to resolve the Company. Moreover, no private right of action may be based on any resolution plan submitted under this provision of the Act.

> The Fed and FDIC are required no later than 18 months after enactment of the Act to jointly issue regulations implementing the provisions regarding resolution plans and credit exposure reports.

1.2.1.1.4. <u>Credit Exposure Report</u>. The Fed must require Companies to submit periodic reports to the Fed and the FDIC regarding the nature and extent of the company's credit exposure to Large BHCs and Significant Nonbanks and the nature and extent to which Large BHCs and Significant Nonbanks have credit exposure to the Company. [§ 165(d)]

1.2.1.1.5. <u>Concentration Limits</u>. The Fed is required to issue regulations to limit the risks that the failure of any Company could pose to Large BHCs and Significant Nonbanks. The Fed's regulations must prohibit Companies from having credit exposure to any unaffiliated company that exceeds 25% of the capital stock and surplus (or a lower amount designated by the Fed) of the company. [§ 165(e)]

Credit exposure is defined to mean: (i) all extensions of credit to a company; (ii) repurchase and reverse repurchase agreements with a company, and securities lending and securities borrowing transactions with a company to the extent that they create credit risk for the Company; (iii) all guarantees and letters of credit issued on behalf of a company; (iv) all purchases of or investments in securities issued by a company; (v) counterparty credit exposure to the company in connection with derivatives transactions between the Company and the Large BHC or Significant Nonbank; and (vi) any other similar transactions that the Fed determines by regulation to be a credit exposure. For purposes of this provision, any transaction by a Company with a person will be deemed to be 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 Federal Home Loan Banks are exempted from any concentration limits. The Fed also has general authority, by regulation or order, to exempt transactions, in whole or in part, from the definition of credit exposure if it finds that the exemption is in the public interest and is consistent with the purpose of the concentration limits provision.

> The credit limits provision of the Act and the Fed's regulations and orders under the provision will not become effective until 3 years after the enactment of Act, subject to an extension of up to an additional 2 years by the Fed.

1.2.1.1.6. Risk Management. In a departure from the general $50 billion threshold for BHCs, the Fed is required to issue regulations requiring each publicly traded BHC with consolidated assets of not less than $10 billion to establish a risk committee. A risk committee is to be responsible for oversight of a company's enterprise-wide risk management practices. The Fed may require each BHC that is a publicly traded company that has consolidated assets of less than $10 billion to establish a risk committee.

The Fed is required to issue final regulations regarding risk committees not later than 1 year after the transfer date (which is generally to be 1 year after the date of enactment of the Act), which regulations shall take effect not less than 15 months after the transfer date.

1.2.1.1.7. Stress Tests. The Fed, in coordination with the appropriate primary financial regulatory agencies and the Federal Insurance Office is required to conduct annual stress tests of Companies to evaluate whether they have the capital necessary to absorb losses as a result of adverse economic conditions. The Act establishes certain requirements for the stress tests. Based on the results of its analysis, the Fed may require a Company to update its resolution plan. The Fed is also required to publish a summary of the stress tests it conducts. [§ 165(i)]

Each Company is required to conduct its own stress test on a semiannual basis. All other financial companies that are regulated by primary Federal financial regulatory agency that have assets of more than $10 billion in assets are required to conduct annual stress tests. All entities required to conduct a stress test must submit a report regarding the test to the Fed and its primary financial regulatory agency in the form specified by the primary financial regulatory agency.

Each Federal primary financial regulatory authority, in coordination with the Fed and the Federal Insurance Office, is required to issue consistent regulations regarding the conduct and reporting of stress tests and requiring companies to publish the results of their stress tests.

1.2.1.1.8. Leverage Limitation in Urgent Circumstances. The Fed shall require a Company to maintain a debt to equity ratio of no more than 15 to 1 if the Oversight Council determines that it poses a grave threat to the financial stability of the U.S. and the imposition of such a requirement is necessary to mitigate the risks posed by the Company. The Federal Home Loan Banks are exempted from the application of this provision. [§ 165(j)]

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| The Fed is required to issue regulations to establish procedures and timelines for complying with the leverage limitation. |

1.2.1.1.9. Inclusion of Off-Balance-Sheet Activities in Computing Capital Requirements. Under this provision, the calculation of a Company's capital for purposes of meeting capital requirements shall take into account any off-balance-sheet activities of the company. Off-sheet-balance activities are defined as an existing liability of a company that is not currently a balance sheet liability, but may become one upon the happening of some future event, including: (i) standby letters of credit, (ii) sale and repurchase agreements, (iii) asset sales with recourse against the seller, and (iv) interest rate swaps. If the appropriate Federal banking agencies determine that an exemption from this requirement is appropriate, the Federal banking agencies may exempt a Company or any transaction from this requirement.

1.2.1.2. Discretionary Standards.

The Fed is also given the discretion to implement, by regulation or order, certain additional requirements in regard to Companies.

1.2.1.2.1. Contingent Capital. After the Oversight Council submits its report on contingent capital to Congress, the Fed may issue regulations that require Companies to maintain a minimum amount of long-term hybrid debt convertible to equity in times of financial distress – contingent capital. In making any determination regarding contingent capital, the Fed is directed to consider, among other things, the Oversight Council's study and its recommendations regarding contingent capital and an appropriate transition period for the implementation of a conversion. [§ 165(c)]

1.2.1.2.2. <u>Enhanced Public Disclosures</u>. The Fed may issue regulations which require periodic public disclosures by Companies in order to support market evaluation of their risk profile, capital adequacy, and risk management. [§ 165(f)]

1.2.1.2.3. <u>Limiting Short-term Debt</u>. The Fed is authorized to issue a regulation limiting the amount of short-term debt, including off-balance sheet exposures that a Company may accumulate. Short-term debt shall be defined by the Fed by regulation, but shall exclude insured deposits. The Fed is authorized to grant Companies that do not control an insured depository institution an exemption from, or adjustment to, any short-term debt limits. [§ 165(g)]

1.2.2. <u>Early Remediation Requirements for Companies</u>. The Fed, in consultation with the Oversight Council and the FDIC, is required to issue regulations establishing requirements to provide for the early remediation of financial distress of a Company. The Act states that nothing in this provision authorizes the provision of financial assistance from the Federal Government. [§ 166] This provision is similar in concept to the Prompt Corrective Action provisions of the Federal Deposit Insurance Act ("FDI Act") that apply to insured depository institutions.

The Fed's regulations are to establish a series of specific remedial actions to be taken by a Company that is experiencing financial distress with the intention of minimizing the probability that the Company will become insolvent and the potential harm of such insolvency to the financial stability of the U.S. The regulations are required to establish measures of the financial condition of a Company, including regulatory capital and liquidity. The regulations must impose increasing restrictions as a Company's financial decline becomes more severe. In the initial stages of financial decline, the regulations are to include limits on capital distributions, acquisitions and asset growth. In the later stages of financial decline, the regulations are to include a requirement for a capital restoration plan, limits on transactions with affiliates, management changes and asset sales.

1.2.3. How Can A "Grave Threat" to U.S. Financial Stability Posed by a Company be Addressed? If the Fed determines that a Company poses a "grave threat" to U.S. financial stability, the Fed, with the approval of the members of Oversight Council, must limit the Company's ability to merge with or acquire another company, restrict its ability to offer a financial product or products, impose conditions on the Company's conducting one or more activities, require the Company to terminate one or more activities, or, if the Fed determines such actions to be inadequate to mitigate the threat, require the Company to transfer assets or off-balance-sheet items to an unaffiliated third party.

A Company subject to any such proposed action may request a hearing. In making its decision, the Fed must take into account the factors that are considered in a determination to designate a company as a Significant Nonbank. The Fed may adopt regulations regarding the application of this provision to foreign Significant Nonbanks and foreign BHCs, giving due regard to the principle of national treatment and equality of competitive opportunity and taking into account the extent to which the affected companies are subject to comparable home country standards applied on a consolidated basis. [§ 121]

1.2.4. New Requirements Regarding Acquisitions. A Company may not acquire direct or indirect ownership or control of any voting shares of any company (other than an insured depository institution) that is engaged in financial activities under Section 4(k) of the

BHC Act that has consolidated assets of $10 billion or more without prior notice to the Fed. [§ 163(b)]

A Company will be required to provide prior notice to the Fed in connection with certain nonbank acquisitions that would otherwise not require prior notice. In reviewing a nonbank acquisition the Fed is directed to consider the extent to which the proposed acquisition would result in greater or more concentrated risks to global or U.S. financial stability or the U.S. economy.

1.2.5. Expanded Application of Interlocks Prohibitions. A Significant Nonbank will be treated as a BHC for purposes of the Depository Institutions Management Interlocks Act. Under this provision the Fed is prohibited from exercising its authority to permit service by a management official of a Significant Nonbank as a management official of a Large BHC or a Significant Nonbank (other than for a temporary exemption for interlocks resulting from a merger, acquisition, or consolidation). [§ 164]

1.2.6. Expanded Examination Authority for the FDIC. The FDIC is given the authority to examine any Company when it determines that a special examination is necessary to determine the condition of the Company for the purpose of implementing its authority to provide for orderly liquidation of such a Company under Title II of the Act. [§ 172] The FDIC is prohibited from exercising such authority with respect to a Company that is in a generally sound condition.

1.2.6.1. FDIC Backup Enforcement Authority. The Act amends the FDIC's backup enforcement authority to provide that the FDIC may take backup enforcement action if the conduct or threatened conduct of a depository institution holding company poses a risk to the Deposit Insurance Fund. This authority is subject to the limitation that such authority may not be used with respect to a depository institution holding company that is in generally sound condition and whose conduct does not pose a foreseeable and material risk of loss to the Deposit Insurance Fund.

1.2.7. Timing of Issuance of Final Regulations. The Act provides that the Fed shall have the authority to issue regulations to implement the subtitles of the Title I other than the subtitle related to the OFR. It further provides that except as otherwise specified, the Fed shall issue final regulations not later than 18 months after the effective date of the Act. [§ 168]

1.3. Leverage and Risk-based Capital Requirements. The Act seeks to generally impose capital requirements at the depository institution holding company and Significant Nonbank level that are at least as strict as those that were in effect at the insured depository institution level on the date of enactment of the Act. This provision has particular importance for the capital treatment of trust preferred securities, which have been accorded more favorable capital treatment at the holding company level than at the depository institution level. [§ 171]

> An amendment by Senator Collins (R-ME) regarding minimum capital requirements was initially adopted in the Senate and would have prohibited BHCs from including trust preferred securities, TARP investments, and potentially other types of hybrid capital as holding company regulatory capital. The Conference Report, however, substantially changed the amendment to grandfather the current capital holdings of companies with less than $15 billion in total consolidated assets and to push back the effective date for new capital requirements for larger bank holding companies to January 1, 2013 with a three-year phase-in period, the details of which will be determined by regulation. (See section 1.3.4.2. below.)

1.3.1. Leverage Capital Requirements. The appropriate Federal banking agencies are required to establish minimum leverage capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies, and Significant Nonbanks. The minimum leverage capital requirements shall not be less than the generally applicable leverage capital requirements which shall serve as a floor for any capital requirements the agency may require. Nor shall such minimum leverage capital requirements be quantitatively lower than generally applicable leverage capital requirements that were in effect for insured depository institutions as of the date of enactment of the Act.

1.3.2. Risk-based Capital Requirements. The appropriate Federal banking agencies are required to establish risk-based capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies, and Significant Nonbanks. The minimum leverage capital requirements shall not be less than the generally applicable risk-based capital requirements which shall serve as a floor for any capital requirements the agency may require. Nor shall such minimum risk-based capital requirements be quantitatively lower than generally applicable leverage capital requirements that were in effect for insured depository institutions as of the date of enactment of the Act.

1.3.3. Treatment of Investments in Financial Subsidiaries. Investments in financial subsidiaries, which are required to be deducted from regulatory capital under the National Bank Act and the FDI Act, need not be deducted from regulatory capital by depository institution holding companies or Significant Nonbanks supervised by the Fed, unless such capital deduction is required by the Fed or the primary financial regulatory agency in the case of Significant Nonbank supervised by the Fed.

1.3.4. Effective Dates

1.3.4.1. Debt or Equity Instruments Issued on or After May 19, 2010. Debt or equity instruments issued on or after May 19, 2010 by a depository institution holding company or a Significant Nonbank are not subject to any grandfathering treatment. They are to be treated as if this provision of the Act was in effect on May 19, 2010.

1.3.4.2. Debt or Equity Instruments Issued Before May 19, 2010. Debt or equity instruments issued before May 19, 2010 by a depository institution holding company or Significant Nonbank are generally subject to a limited grandfathering. Any required regulatory capital deductions with respect to such instruments are to be phased in incrementally over a three-year period that begins on January 1, 2013.

1.3.4.2.1. Exception for Smaller Institutions. Any capital deductions that would otherwise apply do not apply to debt or equity instruments issued before May 19, 2010 by a depository institution holding company with consolidated assets of less than $15 billion as of December 31, 2009, and by organizations that were mutual holding companies on May 19, 2010.

1.3.4.3. Depository Institution Holding Companies not Previously Supervised by the Fed. The requirements imposed under this provision will not apply to any depository institution holding that was not supervised by the Fed as of May 19, 2010 until 5 years after the enactment of the Act, except for the general provisions regarding debt and equity instruments issued before May 19, 2010 or on or after May 19, 2010.

1.3.4.4. Treatment for Certain Bank Holding Company Subsidiaries of Foreign Banking Organizations. With respect to bank holding company subsidiaries of foreign banking organizations that have relied on Fed Supervision and Regulation Letter SR-01-1, the requirements of this provision except for the provision regarding debt and equity instruments issued on or after May 19, 2010 will not apply until 5 years after the date of enactment of the Act.

1.3.4.5. Additional Exceptions. This provision of the Act does not apply to: (i) debt or equity instruments issued to the U.S. or any of its agencies or instrumentalities prior to October 4, 2010 – TARP securities, (ii) any Federal Home Loan Bank, or (iii) any small bank holding company subject to the Fed's Small Bank Holding Company Policy Statement as in effect on May 19, 2010.

1.3.5. Capital Requirements to Address Activities that Pose Risks to the Financial System. Subject to the recommendations of the Oversight Council, the Federal banking agencies are directed to develop capital requirements applicable to insured depository institutions, depository institution holding companies, and Significant Nonbanks that address the risks that the activities of such institutions pose to the institution engaging in the activity and to other public and private parties in the event of the adverse performance, disruption, or failure of the institution or activity. The rules must address risks arising from (i) significant volumes of activity in derivatives, securitized products, financial guaranties, securities borrowing and lending, and repurchase agreements and reverse repurchase agreements; (ii) concentrations in assets for which the values presented in financial reports are based on models rather than historical cost or prices derived from deep and liquid markets; and (iii) concentrations in market share for any activity that would substantially disrupt financial markets if the institution is forced to unexpectedly cease the activity.

1.3.6. Study Regarding Small Institution Access to Capital. The Comptroller General after consultation with the Federal banking agencies is directed to conduct a study of access to capital by depository institutions with consolidated assets of less than $5 billion. The study and any recommendations for legislative action are to be submitted to Congress not later than 18 months after the date of enactment of the Act.

1.4. Establishment of the OFR. The Act establishes the OFR as an office within the Treasury. The OFR will be headed by a Director, who serves a six-year term and will be appointed by the President subject to confirmation by the Senate. [§ 152] The purpose of the OFR is to support the activities of the Oversight Council by, among other things, collecting data, performing research and developing tools for risk measurement. [§ 153] During the two-year period following the date of enactment of the Act, the Fed is required to provide the OFR an amount of funds adequate to cover the OFR's expenses. After that time the Treasury Secretary is required to establish by regulation, with the approval of the Oversight Council, an assessment schedule applicable to Large BHCs and Significant Nonbanks, which takes into account the differences between such Companies to collect assessments equal to expenses of the OFR. [§ 155]

**Title II**

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2. Title 2 – Orderly Liquidation Authority.

This Title is intended to ensure that Federal authorities will have the ability to address financial distress at companies that could have a significant impact on U.S. financial stability. This approach responds to concerns that Federal authorities were hampered in dealing effectively with large non-bank institutions during the 2008 financial crisis because they lacked the type of authority that the Federal banking agencies, including the FDIC, are able to bring to play when a large depository institution is in a seriously troubled condition.

Under the Act, Federal authorities will be able to place both Large BHCs and Significant Nonbanks in receivership under Federal control. The receivership would be charged with liquidating the institution. It would operate under principles largely drawn from the receivership provisions of the FDI Act that govern receiverships of insured depository institutions.

While this approach will provide significant new tools for Federal regulators to deal with threats to U.S. financial stability, it will create significant uncertainties for companies, that because of their size or interconnections with other major financial services firms, could potentially become the subject of a Federal receivership action. These companies and their equity holders, creditors, borrowers, customers, vendors and counterparties will have no assurance in advance as to whether financial distress at the company will be dealt with in a Chapter 11 reorganization or a Chapter 7 liquidation under the Bankruptcy Code, or a Federal receivership under Title II.

These alternative approaches are triggered by different conditions at the distressed company. They are designed to achieve different objectives. Furthermore, they provide different types of opportunities to participate in the resolution process and offer different rights to the various categories of constituents. This is likely to generate a fundamental reevaluation of how significant BHCs and non-BHCs and their constituents consider positioning themselves in relation to the possibility that a company could find itself in financial distress and either be placed in bankruptcy or Federal receivership.

If a Federal receivership is triggered, there will be significant attention on how it is handled. The controversy regarding the concept of "too big to fail" will place a high level of focus on how various constituents of the institution in receivership are treated and whether the resolution amounts to a "bail out" of certain parties.

2.1. Companies Eligible for Orderly Liquidation. The Act authorizes the Federal government to place certain types of entities in receivership. Companies that are potentially subject to receivership are referred to as "covered financial companies". Farm Credit institutions would be excluded from this definition.

A "financial company" is any company that is incorporated or organized under Federal law or state law, that is:

- a BHC;

- a Significant Nonbank;

- any company that is predominantly engaged in activities that the Fed has determined are financial in nature or incidental thereto under Section 4(k) of the BHC Act (other than a BHC or a Significant Nonbank), or

- any subsidiary of the foregoing types of companies that is predominantly engaged in activities that the Fed has determined are financial in nature or incidental thereto under Section 4(k) of the BHC Act (other than a subsidiary that is an insured depository institution or an insurance company).

For purposes of the term "financial company," a company will not be deemed to be engaged in financial activities for purposes of Section 4(k) of the BHC Act if the consolidated revenue of such company from such activities constitutes less than 85 percent of total consolidated revenues, as the FDIC, in consultation with the Treasury Secretary, shall establish by regulation.

2.2. <u>Process for Designating a Covered Financial Company for Orderly Liquidation</u>. The Act establishes a multi-step, high-level process for determining whether to place a company in receivership that may include a prior judicial approval component that is not present in the depository institution receivership process.

2.2.1. <u>Recommendation of the Fed and the FDIC Regarding a Receivership to the Treasury Secretary</u>. As a general matter, the Fed and the FDIC, either on their own initiative or at the request of the Treasury Secretary, are responsible for considering whether to make a recommendation as to whether the Treasury Secretary should appoint the FDIC as receiver for a financial company. [§203(a)] In the case of an insurance company that is a covered financial company or a subsidiary or affiliate of such a company, the liquidation will be conducted under state law either by the appropriate regulatory agency or the FDIC on a backup basis.

A receivership recommendation must be approved by a vote of at least 2/3's of the members of the board of directors of both the Fed and the FDIC. In the case of a broker or dealer, the FDIC's role is assigned to the SEC. In the case of an insurance company, the FDIC's role is assigned to the Director of the Federal Insurance Office.

The written recommendation must, among other things, contain:

- an evaluation of whether the financial company is in default or in danger of default (such terms being satisfied if (i) a case has been, or likely will promptly be, commenced with respect to the company under the Bankruptcy Code, (ii) the financial company has incurred, or is likely to incur losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion, (iii) the assets of the financial company, are, or are likely to be, less that its obligations to creditors and others, or (iv) the financial company is, or is likely to be, unable to pay its obligation in the normal course of business);

- a description of the effect that the default would have on financial stability in the U.S.;

- a recommendation regarding the nature and extent of actions to be taken under Title II regarding the financial company;

- an evaluation of the likelihood of a private sector alternative to prevent default of the financial company;

- an evaluation of why a case under the Bankruptcy Code is not appropriate for the financial company;

- an evaluation of the effects on creditors, counterparties, and shareholders of the financial company and other market participants; and

- an evaluation of whether the company qualifies as a financial company.

2.2.2. <u>Determination for Receivership by the Treasury Secretary</u>. A receiver for a financial company will be appointed (subject to judicial review) if, upon the written recommendation of the Fed and the FDIC (or other applicable Federal regulatory agency), the Treasury Secretary, in consultation with the President, determines that:

- the financial company is in default or in danger of default;

- the failure of the financial company and its resolution under other applicable law would have serious adverse effects on financial stability in the U.S.;

- no viable private sector alternative is available to prevent the default of the financial company;

- any effect on the claims or interests of creditors, counterparties, and shareholders of the financial company and other market participants, as a result of actions to be taken under Title II is appropriate given the impact that any action taken under Title II would have on financial stability in the U.S.;

- any action involving the appointment of a receiver would avoid or mitigate such adverse effects, taking into account the effectiveness of the action in mitigating potential adverse effects on the financial system, the cost to the general fund of the Treasury, and the potential to increase excessive risk taking on the part of creditors, counterparties, and shareholders in the financial company;

- a Federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments that are subject to the regulatory order; and

- the company qualifies as a financial company. [§203(b)]

2.2.3. <u>Notice to Covered Financial Company; Judicial Approval</u>. Upon a determination by the Treasury Secretary to place a covered financial company in receivership, the Treasury Secretary must notify the FDIC and the company. If the board of directors of the company acquiesces or consents to the appointment of the FDIC as receiver, the Treasury Secretary shall appoint the FDIC as receiver. [§202] The members of the board of directors of a covered financial company will not be liable to the shareholders or creditors thereof for acquiescing in or consenting in good faith to the appointment of the FDIC. [§207]

If the board of directors of the company does not acquiesce or consent to the appointment of the FDIC, the Treasury Secretary is required to petition the U.S. District

Court for the District of Columbia for an order authorizing the Treasury Secretary to appoint the FDIC as receiver for the company.

The Treasury Secretary must file the recommendations and the determination with the Court under seal. The Court, with notice to the covered financial company, but on a strictly confidential basis, and without any prior public disclosure, is required to hold a hearing at which the company may oppose the Treasury Secretary's petition. Any person who recklessly discloses a determination by the Treasury Secretary, the filing of a petition, or the pendency of a proceeding before the Court may be subject to criminal penalties. The Court's review is limited to whether the Treasury Secretary's determination that (i) the covered financial company is in default or in danger of default, and (ii) that it qualifies as a financial company, is arbitrary and capricious.

If the Court determines that the Treasury Secretary's determination is not arbitrary and capricious, the Court is required to issue an order authorizing the Treasury Secretary to appoint the FDIC as receiver. If the Court, on the other hand, determines that the Treasury Secretary's determination is arbitrary and capricious, the Court shall provide a written statement of the reasons supporting its determination and provide the Treasury Secretary an immediate opportunity to refile the petition.

If the Court does not make a determination within 24 hours of receipt of the petition, the petition will be granted by operation of law, the Treasury Secretary shall appoint the FDIC as receiver, and the liquidation shall automatically be commenced. Given the right of the covered financial company to have a hearing on the Treasury Secretary's petition, the 24 hour time limit for action by the Court creates an extraordinarily tight time schedule for the Court and the covered financial company. In apparent recognition of this issue the Court is required, within 6 months of enactment of the Act, to issue rules and procedures as may be necessary to ensure the orderly conduct of the proceedings, including that the 24-hour deadline is met.

The decision of the Court is not subject to any stay or injunction pending appeal. The covered financial company or the Treasury Secretary may appeal an adverse decision by the Court to the U.S. Court of Appeals for the District of Columbia Circuit. The scope of the appeal is limited to the issues to have been considered by the Court. Ultimately, either party can seek review by the Supreme Court, which will be limited to the same scope of review.

If the FDIC is appointed as receiver for any covered broker or dealer (*i.e.*, a covered financial company that is an SEC registrant and member of the Securities Investor Protection Corporation ("SIPC")), the FDIC is directed to appoint, without any need for court approval, the SIPC to act as trustee for the liquidation of the covered broker or dealer. Additional provisions concerning the liquidation of a covered broker or dealer are contained in Title II, but are not discussed further in this summary. [§205]

2.3. <u>Principles Governing Orderly Liquidation</u>. The goal of a receivership under Title II is to provide the authority to liquidate failing financial companies that pose a significant risk to the financial stability of the U.S. in a manner that mitigates such risk and minimizes moral hazard. [§204] The authority provided in Title II is to be exercised in a manner that best fulfils that purpose, so that:

- creditors and shareholders will bear the losses of the financial company;
- management responsible for the condition of the financial company will not be retained; and
- the FDIC and other appropriate agencies will take all steps to assure that all parties, including management and third parties, having responsibility for the condition of the financial company, bear losses consistent with their

responsibility, including actions for damages, restitution, and recoupment of compensation and other gains not compatible with such responsibility.

The FDIC is required to consult with the primary Federal regulator of the covered financial company and any functional regulator of any subsidiaries of the company that are not covered subsidiaries.

2.4. Obligations of the FDIC as Receiver. In taking action as a receiver the FDIC must:

- determine that the actions it takes are necessary for the purposes of preserving the financial stability of the U.S., and not for the purpose of preserving the financial company;

- ensure that shareholders of a covered financial company do not receive payment until after all other claims and the Orderly Liquidation Fund ("Liquidation Fund") are fully paid;

- ensure that unsecured creditors bear losses in accordance with the priority of claim provisions in Title II;

- ensure that management responsible for the failed condition of the covered financial company is removed, if management has not already been removed at the time the FDIC is appointed receiver;

- ensure that the members of the board of directors responsible for the failed condition of the covered financial company are removed, if they have not already been removed at the time the FDIC is appointed receiver; and

- not take an equity interest in or become a shareholder of any covered financial company or any covered subsidiary. [§206]

2.5. Dismissal and Exclusion of Other Actions Involving the Covered Financial Company. On the date that the FDIC is appointed as receiver, any case or proceeding commenced with respect to a covered financial company under the Bankruptcy Code shall be dismissed upon notice to the Bankruptcy Court, provided that any order entered or other relief granted by a bankruptcy court prior to the date of the appointment of the FDIC as receiver shall continue with the same validity as if an orderly liquidation had not been commenced. Moreover, no bankruptcy case or proceeding may be commenced with respect to a covered financial company at any time while the orderly liquidation is pending. [§208]

2.6. Rulemaking by the FDIC Regarding Receiverships. The FDIC is required to issue rules and regulations to implement Title II, including rules and regulations regarding the rights, interests, and priorities of creditors, counterparties, secured parties, or other parties with respect to any covered financial company or any assets or other property of or held by such covered financial company, and to address the potential for conflicts of interest between among FDIC receiverships under Title II and the FDI Act. The FDIC, to the extent possible, is to harmonize applicable rules and regulations under Title II with the insolvency laws that would otherwise apply to a covered financial company. [§209]

2.7. Powers and Duties of the FDIC. The receivership authority of the FDIC and the procedures for the conduct of receivership under Title II are largely drawn from the similar provisions for depository institution receiverships under FDI Act. [§210] The FDIC is given a wide range of powers and accorded significant deference to carry out its receivership and resolution functions.

The receivership process established by the Act is far different from the process in a bankruptcy proceeding, particularly a Chapter 11 reorganization. There is no neutral party that plays a role like a bankruptcy judge. Claimants have a very limited right to judicial review in a proceeding that generally involves only their claim, rather than participation in a proceeding where all relevant parties are represented and assert their positions in a single transparent forum and argue for a particular type of approach for the future of the troubled entity. In Title II receivership, the FDIC decides what the resolution approach will be and how particular creditors will be treated, including the potential for different treatment among the same priority of creditors.

2.7.1. General Powers. Upon appointment as receiver, the FDIC succeeds to all rights, powers and privileges of the covered financial company and of any stockholder, officer or director of the company. [§210(a)(1)]

2.7.2. Operation of the Covered Financial Company. The FDIC may operate the company and conduct all its business, collect all obligations and money owed to the company, and manage the assets and property of the company (consistent with the maximization of the value of the assets in the context of an orderly liquidation). The FDIC as receiver is directed to liquidate and wind-up the affairs of the company, in a manner that the FDIC deems appropriate, including through the sale of assets, the transfer of assets to a bridge financial company or the exercise of any other rights or privileges granted to the receiver under Title II. When appointed as receiver of a covered financial company, the FDIC may appoint itself a receiver of any covered subsidiary of the covered financial company if certain findings regarding the subsidiary are made by the FDIC and the Treasury Secretary.

2.7.3. Merger; Transfer of Assets and Liabilities. The FDIC as receiver, may (i) merge the covered financial company with another company, or (ii) transfer any asset or liability (including any assets or liabilities held by the covered financial company for secured parties, any customer property, or any assets or liabilities of any trust or custody business) without obtaining any approval, assignment, or consent with respect to such transfer (other than antitrust clearance, as applicable).

2.7.4. Payment of Valid Obligations. The FDIC as receiver is required, to the extent that funds are available, to pay all valid obligations of the covered financial company that are due and payable at the time of the appointment of the FDIC as receiver.

2.7.5. Treatment of Shareholders and Creditors of the Covered Financial Company. The FDIC as receiver succeeds to all the rights, titles, powers, and privileges of the company, and shall terminate all rights and claims that the stockholders and creditors of the covered financial company may have against the assets of the company or the FDIC arising out of their status as stockholders or creditors, except for the right to payment, resolution, or other satisfaction of their claims, as permitted under Title II. The FDIC is required to ensure that shareholders and unsecured creditors shall bear losses, consistent with the priorities established by Title II.

2.7.6. Suspension of Legal Actions. After the appointment of the FDIC as receiver, the FDIC may request, and a court shall grant, a stay in any legal action or proceeding in which the covered financial company is or becomes a party for a period not to exceed 90 days.

2.7.7. Limitation on Judicial Review. Except as otherwise provided in Title II, no court shall have jurisdiction over any claim or action for payment from, or any action seeking a determination of rights with respect to, the assets of the covered financial company, including any assets which the FDIC may acquire from itself as receiver, or any claim relating to any act or omission of the covered financial company of the FDIC as receiver. Title II provides exceptions for judicial review of disallowed claims and the continuation of pre-receivership claims.

2.7.8. Objectives in the Disposition of Assets. The FDIC, in exercising its powers as receiver, including in connection with the sale of assets, is directed, among other things, to (i) maximize the net present value return from any sale or disposition, (ii) minimize the amount of any loss realized in the resolution of cases, (iii) mitigate the potential for serious adverse effects to the financial system, and (iv) ensure fair treatment of offerors.

2.7.9. Fraudulent Transfers, Preferential Transfers, Setoffs. The FDIC has the authority to avoid transfers that constitute fraudulent transfers or preferential transfers under Title II, as well as unauthorized post-receivership transfers of property, subject to certain rights and defenses of transferees. The Act also recognizes the right of a creditor of a covered financial company to offset a mutual debt owed by the creditor to the company subject to certain restrictions.

2.7.10. Attachment of Assets and Other Injunctive Relief. The FDIC as receiver may request an order for an attachment of the assets of any person designated by the FDIC subject to a lower standard for relief than is normally required.

2.7.11. Priority of Claims. The Act establishes the following priorities for unsecured claims against the covered financial company or the FDIC as receiver:

- Administrative expenses of the receiver;
- Amounts owed to the United States;
- Wages, salaries, or commissions, earned not later than 180 days before the appointment of the FDIC as receiver, subject to a specified cap;
- Contributions owed to employee benefit plans arising from services rendered not later than 180 days before the appointment of the FDIC as receiver, subject to a specified cap;
- Any other general or senior liability of the covered financial company;
- Any obligation subordinated to general creditors;
- Any wages, salaries, or commissions owed to senior executives and directors of the covered financial company;

- Any obligations to shareholders, members, general or limited partners, or other persons with interests in the equity of the covered financial company.

2.7.11.1. Post-receivership Financing Priority. If the FDIC as receiver for a covered financial company is unable to obtain unsecured credit for the company from commercial sources, the FDIC as receiver may obtain credit or incur debt on the part of the company, which shall have priority over any or all administrative expenses of the receiver.

2.7.12. Treatment of Similarly Situated Creditors. All claimants of a covered financial company that are similarly situated in terms of priority are to be treated in a similar manner, except that FDIC may take any action that does not comply with this provision if the FDIC determines that such action is necessary:

- to maximize the value of the assets of the covered financial institution;
- to initiate and continue operations essential to implementation of the receivership or any bridge financial company;
- to maximize the present value return from the sale or other disposition of the assets from the sale or other disposition of the assets of the covered financial company; or
- to minimize the amount of any loss realized upon the sale or other disposition of the assets of the covered financial company; and
- all claimants that are similarly situated receive not less than the amount that the claimant would have received if the FDIC had not been appointed receiver with respect to the covered financial company, and the company had been liquidated under Chapter 7 of the Bankruptcy Code or any similar provision of state insolvency law applicable to the covered financial company.

2.7.12.1. Secured Claims Not Affected. The FDIC's authority to differentiate among creditors under certain circumstances as described above does not affect secured claims or security entitlements in respect to assets or property held by the covered financial company, except to the extent that the security is insufficient to satisfy the claim, and then only with regard to the difference between the amount of the claim and the amount realized from the security.

2.7.13. Valuation of Claims; Discretion to Make Additional Payments. As noted above, the FDIC's maximum liability to a claimant is limited to the amount that the claimant would have received in the absence of an FDIC receivership if the company had been liquidated under Chapter 11. In a provision that has the potential to generate some controversy depending on how it is employed, the Act provides that the FDIC, with the approval of the Treasury Secretary, may make additional payments to any claimant or category of claimants if the FDIC determines that such payments are necessary or appropriate to minimize losses to the FDIC as receiver from the orderly liquidation of the company. Any such payments are, however, limited to the extent that they cannot result in a claimant receiving more than the face value of a claim that is prove to the satisfaction of the FDIC.

2.8. Determination of Claims Against the Covered Financial Company. The FDIC as receiver is charged with making determinations regarding claims related to the covered financial company in accordance with the requirements established by the Act and by regulations issued by the FDIC for covered financial company receiverships. [§ 210(a)(2)]

2.8.1. Notice to Creditors. The FDIC is required to publish notice to creditors of a covered financial company by a specified date which shall be no earlier than 90 days after the date of publication. The FDIC is also required to mail notice to creditors.

2.8.2. FDIC Response to Claims; Recognition of Secured Claims. Prior to 180 days after the FDIC receives a claim (unless extended by agreement with the claimant), the FDIC is to notify a claimant whether it accepts or objects to the claim. The FDIC is authorized to object to any portion of a claim by a creditor, claim of security, preference, setoff, or priority that is not proven to the satisfaction of the FDIC, except that this provision does not apply to any extension of credit from a Federal Reserve Bank or the FDIC to the covered financial company, or to any legally enforceable and perfected security interests in the assets of the covered financial company, subject to the limitations for unsecured claims.

2.8.2.1. Expedited Determination of Certain Claims. The FDIC is required to establish a procedure for expedited relief outside of the normal claims process for any claimant who alleges the existence of a legally valid and enforceable or perfected security interest in property of a covered financial company, and that irreparable injury will occur if the normal claims procedure is followed. In such instances, the FDIC is required to make a determination prior to the end of the 90 day period.

2.8.3. Treatment of Undersecured Claims. In the case of a claim against a covered financial company that is secured by any property or other asset of such company, the FDIC may treat the portion of such claim which exceeds an amount equal to fair market value of such property or other asset as an unsecured claim and may not make any payment with respect to such unsecured portion of the claim, except in connection with the disposition of all claims of unsecured creditors.

2.8.4. Judicial Determination of Claims. A claimant may file suit on a claim in the U.S. District Court for the district in which the principal place of business of the covered financial institution is located. Such a claim must be filed before the end of a specified 60 day period. If a claimant fails to file a timely suit, the disallowance of the claim will be final.

2.8.5. Agreements Against the Interest of the FDIC. The Act contains a provision, similar to one in the FDI Act that has been the subject of much litigation, which provides that no agreement that tends to diminish or defeat the interest of the FDIC as receiver in any asset acquired by the receiver shall be valid against the receiver, unless the agreement (i) is in writing, (ii) was executed by an authorized party at the covered financial company, or confirmed in the ordinary course of business by the covered financial company, and (iii) has been, since the time of its execution, an official record of the company or the party claiming under the agreement, and the claimant provides documentation, acceptable to the receiver, of such agreement and its authorized execution or confirmation by the covered financial company.

2.8.6. Payment of Claims. The FDIC as receiver may, in its discretion and to the extent funds are available, pay creditor claims that are allowed by the receiver or are determined by the final judgment of a court. The FDIC as receiver may, in its sole discretion, pay dividends on proven claims. The FDIC may prescribe rules to establish an interest rate for or to make payments of post-insolvency interest to creditors holding proven claims against the receivership of covered financial company, except that no such interest shall be paid until the FDIC as receiver has satisfied the principal amount of all creditor claims.

2.9. Treatment of Contracts Entered Into Prior to Appointment of the Receiver; Authority to Repudiate. The FDIC is given a very broad power to repudiate contracts. In the depository institution receivership context, the exercise of this authority and its potential for undoing significant pre-receivership transactions such as securitizations has generated significant litigation regarding FDIC's exercise of this authority and counterparty concerns regarding actions that an FDIC receiver might take. These considerations will now play out in connection with the hypothetical receivership of a new category of entities. [§210(c)]

2.9.1. General Authority to Repudiate Contracts. The FDIC as receiver may disaffirm or repudiate any contract or lease:

- to which the covered financial company is a party;
- the performance of which the FDIC as receiver, in the discretion of the FDIC, determines to be burdensome; and
- the disaffirmance or repudiation of which the FDIC as receiver determines, in its discretion, will promote the orderly administration of the affairs of the covered financial company.

The FDIC as receiver must determine whether to exercise its repudiation rights within a reasonable period of time.

2.9.2. Claims for Damages for Repudiation. As a general matter, the liability of the FDIC as receiver for the disaffirmance or repudiation of any contract is limited to actual direct compensatory damages, and is determined as of (i) the date of the appointment of the receiver, or (ii) in the case of a qualified financial contract ("QFC"), the date of the disaffirmance of such contract or agreement. The term "actual direct compensatory damages" does not include (i) punitive or exemplary damages, (ii) damages for lost profits or opportunity, or (iii) damages for pain or suffering. In certain instances, special damages rules apply as discussed below.

2.9.2.1. Damages for Repudiation of a QFC. In the case of a transaction treated as a QFC, compensatory damages shall be deemed to include normal and reasonable costs of cover or other reasonable measures of damages utilized for such contract and agreement claims.

2.9.2.2. Damages for Repudiation of Debt Obligations. In the case of any debt for borrowed money or evidenced by a security, actual direct compensatory damages generally shall be no less than the amount lent plus accrued interest plus any accreted original issue discount as of the date the FDIC is appointed receiver.

2.9.2.3. Damages for Repudiation of a Contingent Obligation. In the case of any contingent obligation of a covered financial company that consists of any obligation under a guarantee, letter of credit, loan commitment, or similar credit obligation, the FDIC may by rule or regulation, prescribe that actual direct compensatory damages shall be no less than the estimated value of the claim as of the date the FDIC was appointed receiver, as such value is measured based on the likelihood that such contingent claim would become fixed and, if so, its probable magnitude.

2.9.2.4. Damages for Leases Under Which the Company Is Lessee. Damages for the repudiation of the company's position as a lessee are limited to the amount of contractual rent accruing before the later of the date notice of repudiation is mailed or the repudiation becomes effective. The lessor shall have no claim for damages under any acceleration clause or other penalty provision. The lessor shall have a claim for any unpaid rent, subject to all appropriate offsets and defenses, due as of the date of the appointment of the FDIC as receiver.

2.9.2.5. Damages for Leases Under Which the Company is the Lessor. If the FDIC repudiates an unexpired lease where the lessee is not in default, the lessee may treat the lease as terminated or remain in possession for the balance of the term, unless the lessee defaults after the date of repudiation.

2.9.2.6. Damages for Contracts for Sale of Real Property. If the FDIC repudiates a contract for the sale of real property, and the purchaser is in possession and is not in default on the date of repudiation, the purchaser may either treat the contract as terminated or remain in possession subject to continuing to making all payments due under the contract.

2.9.2.7. Damages for Service Contracts. In the case of any contract for services, any claim for services performed before the appointment of the receiver shall be deemed to have arisen on the date the receiver was appointed. If the receiver accepts services from the provider after its appointment, the party shall be paid under the terms of the contract for pre-repudiation services and the amount of such payment shall be treated as an administrative expense of the receivership.

2.9.3. Treatment of QFCs. As a general matter, no party will be stayed or prohibited from exercising (i) any right the party has to cause the termination, liquidation, or acceleration of any QFC with a covered financial company which arises upon the date of appointment of the FDIC as receiver for such company at any time after such appointment, (ii) any right under any security agreement or arrangement or other credit enhancement related to one or more QFCs, or (iii) any right to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with one or more QFCs. A QFC means any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, and any similar agreement that the FDIC determines by regulation, resolution, or order to be a QFC.

2.9.3.1. Transfer of QFCs. In making any transfer of assets or liabilities of a covered financial company in default, which includes any QFC, the FDIC as receiver must either (i) transfer to one financial institution which is not in receivership or bankruptcy all QFCs between a person or any affiliate thereof and the company, and related claims, security property, and credit enhancements, or (ii) transfer none of the QFCs, claims, property or credit enhancements. The FDIC must provide notice if it transfers any QFC by not later than 5:00 p.m. Eastern time on the day after the FDIC is appointed receiver. A person that is a party to a QFC with a covered financial company may not exercise any right to terminate, liquidate or net such contract solely by reason of the appointment of the FDIC as receiver or the insolvency or financial condition of the company until the earlier of (i) the time at which the person has received notice that the QFC has been transferred, or (ii) 5:00 p.m. Eastern time on the business day following the date of the appointment of the FDIC.

2.9.3.2. Repudiation of QFCs. In exercising its repudiation rights with respect to any QFC, the FDIC shall either repudiate all QFCs between any person and its affiliates and the covered financial company, or repudiate none of the QFCs.

2.9.4. Certain Security Interests Are Not Avoidable. The FDIC's repudiation power does not permit it to avoid any legally enforceable or perfected security interest in any assets of any covered financial company, except as permitted with respect to fraudulent, preferential or unauthorized transfers, or to avoid any legally enforceable interest in customer property, security entitlements in respect of assets, or property held by the company for any security entitlement holder.

2.9.5. Authority to Enforce Contracts. The FDIC as receiver may enforce any contract (other than certain insurance policies) notwithstanding any provision of the contract providing for termination, default, acceleration, or exercise of rights upon, or solely by reason of, insolvency, the appointment of the FDIC as receiver, the filing of a petition for receivership, or related matters.

As a general matter, no person may exercise any right or power to terminate, accelerate, or declare a default under any contract to which the covered financial company is a party (and no such provision shall be enforceable) or to obtain possession of or exercise control over any property of the company or affect any financial rights of the company without the consent of the FDIC as receiver during the 90 day period beginning from the appointment of the FDIC. This provision does not apply to certain insurance policies, or to the rights of parties to a QFC or certain netting contracts. Nor may it be construed to permit the FDIC to fail to comply with otherwise enforceable provisions of a contract.

2.9.7. Contracts to Extend Credit to a Covered Financial Company. In the event that the FDIC as receiver enforces any contract to extend credit to a covered financial company or bridge financial company, any valid and enforceable obligation to repay such debt shall be paid by the FDIC as receiver, as an administrative expense of the receivership.

2.9.8. Limitation on Court Action. Except as otherwise permitted in Title II, no court may take any action to restrain or affect the exercise of powers or functions of the receiver, and any remedy against the FDIC or receiver shall be limited to money damages.

2.9.9. Claims Against Directors and Officers. A director or officer of a covered financial company may be held personally liable for monetary damages in a civil action based on a claim for gross negligence or more serious conduct brought by the FDIC.

2.10. The FDIC's Authority to Establish Bridge Financial Companies. The Act gives the FDIC an important element of flexibility in carrying out its liquidation responsibility by authorizing it to establish one or more companies known as a bridge financial company either in connection with an existing receivership or in anticipation of a potential receivership. A bridge financial company has the authority to purchase assets and assume liabilities from a covered financial company as determined by the FDIC in its discretion. [§210(h)]

2.10.1. Structure of a Bridge Financial Company. A bridge financial company will operate under a board of directors appointed by the FDIC. It may operate without any capital or surplus, although the FDIC may authorize the company to issue stock. The FDIC may also make funds available to the bridge financial company for its operations in lieu of capital.

The same principles discussed above in regard to the treatment of creditors of a covered financial company, including the potential to treat similarly situated creditors differently, subject to satisfaction of a minimum payment requirement to disfavored creditors, apply in connection with the establishment of a bridge financial company.

2.10.2. Term of a Bridge Financial Company. The status of a bridge financial company as such an entity will end 2 years after it is established, subject to the potential for up to three 1-year extensions. A company's status as a bridge company will terminate, among other events, upon (i) a merger with another company that is not a bridge financial company, or (ii) at the election of the FDIC, the sale of a majority of the capital stock of the bridge financial company. The FDIC also has the authority to dissolve the bridge financial company.

2.10.3. Borrowings by a Bridge Financial Company. A bridge financial company is authorized to obtain unsecured credit or debt. If the company is not able to obtain such funds, it may, with the approval of the FDIC, issue debt that has priority over any obligations of the bridge financial company, and that is secured by a lien on property of the company that is not otherwise subject to a lien. In a notable provision, the FDIC, after notice and a court hearing with the impacted lien holders, may authorize the issuance of debt by the bridge financial company secured by a senior or equal lien on property of the company that is already subject to a lien if the company is otherwise unable to obtain such credit and there is adequate protection for the interest of the holder of the lien on the property as to which the senior or equal lien is to be granted. No credit or debt obtained or issued by a bridge financial company may impair the rights of a counterparty to a QFC other than with respect to the priority of any unsecured claim.

2.11. Orderly Liquidation Fund. The Act establishes a Orderly Liquidation Fund ("Liquidation Fund") in the Treasury that is available to the FDIC in connection with its receivership operations under the Act. The FDIC upon appointment as a receiver is authorized to issue obligations to the Treasury Secretary. The FDIC's issuance of obligations in connection with the liquidation of a covered financial company may not exceed (i) an amount equal to 10 percent of the total consolidated assets of the company, and (ii) an amount that is equal to 90 percent of the fair value of the total consolidated assets of the company that are available for repayment. The FDIC and the Treasury Secretary are required to jointly issue regulations regarding the calculation of the maximum obligation limitation. The Treasury Secretary may not purchase any obligations unless there is an agreement between the Treasury Secretary and the FDIC that provides a specific plan for repayment of such borrowing and that demonstrates that the FDIC's income from the assets of the covered financial company and assessments on eligible financial companies will be sufficient to amortize the borrowings within a specified time period. [§210(n)]

2.11.1. <u>Orderly Liquidation and Repayment Plans</u>. Amounts in the Liquidation Fund will be made available to the FDIC in connection with a receivership of a covered financial company upon acceptance by the Treasury Secretary of an orderly liquidation plan for the company.

2.11.2. <u>Assessments on Eligible Financial Companies</u>. The Act authorizes the FDIC to charge one or more risk-based assessments on eligible financial companies, if such assessments are necessary for the FDIC to repay obligations issued to the Treasury Secretary within 60 months of the issuance of such obligations. Eligible financial companies are defined as a BHC with assets of $50 billion or more or a Significant Nonbank.

The FDIC, subject to recommendations from the Oversight Council, is required to develop a risk matrix to be used to impose assessments. Assessments are to be imposed on a graduated basis, with higher assessments on companies with greater assets and risk. The factors to be considered by the Oversight Council and the FDIC in assessing risk include: (i) economic conditions, with the intention of having higher assessments during favorable economic conditions and lower assessments during less favorable economic conditions, (ii) other assessments (such as deposit insurance assessments) on the financial company or its affiliates, (iii) the risks presented by the company to the financial system and the likelihood that the company likely would benefit from an orderly liquidation, (iv) any risks presented by the financial company during the 10 years prior to appointment of the FDIC as receiver that contributed to the failure of the institution in receivership, and (v) any other risk-related factors deemed to be appropriate.

> The FDIC, in consultation with the Treasury Secretary, is required to issue regulations to carry out the assessment process. The regulations must take into account the differences among companies in risks posed by particular companies and other factors to ensure that assessed companies are treated equitably.

2.12. Required Liquidation of Companies in Receivership; Prohibition on Taxpayer Funding. The Act contains several provisions intended to address public concerns about taxpayer "bailouts." The Act provides that all financial companies placed in receivership shall be liquidated. It also states that no taxpayer funds shall be used to prevent the liquidation of any financial company under the Act.

The Act requires that all funds expended in the liquidation of a financial company shall be recovered from the disposition of assets of the company, or shall be the responsibility of the financial sector through assessment. Finally, the Act provides that taxpayers shall bear no losses from the exercise of any authority under Title II. [§214]

2.13. Unenforceability of Certain Agreements. The Act provides that any provision in an agreement that limits or prohibits a party from acquiring all or part of a covered financial company in a transaction involving the FDIC, or from using any previously disclosed information in connection with any such offer to acquire such a company shall be unenforceable.

2.14. Prohibition on Asset Sales to Certain Persons. As is the case with sales of failed depository institution assets, the FDIC is required to issue regulations that prohibit the sale of assets of a covered financial company in receivership to persons who have engaged in certain conduct including defaults on obligations to the company or participation in any transaction that resulted in a substantial loss to the company. [§210(r)]

2.15. Recovery of Compensation from Senior Executives and Directors. The Act provides that the FDIC, as a receiver for a covered financial company, may recover from any current or former senior executive officer or director that is substantially responsible for the failed condition of the company any compensation received during the 2-year period preceding the receivership, except that no time limit will apply in the case of fraud. This provision diverges from accepted legal concepts by triggering liability based on a person's "responsibility" for a company's condition, rather than on some level of culpability such as negligence, gross negligence, or willful misconduct. A person might be deemed to be responsible for a company's condition as a result of a particular business decision, but that decision might not be deemed to have been negligent or might be protected by the business judgment rule. [§210(s)]

> The FDIC is required to issue regulations to implement the compensation recovery provision. The regulations are required to define the term "compensation" to include financial remuneration such as salary, benefits, severance, deferred compensation, golden parachute benefits, and any profits realized from the sale of company securities.

2.16. Inspector General Reviews. Reviews of the failure of depository institutions by banking agency inspector generals have attracted a high level of attention and have put a great deal of focus on the effectiveness of agency supervision. Similarly, the Act requires the FDIC's Inspector General to conduct audits and investigations of the liquidation of any covered financial company and to report on its findings. The Inspector General of the Treasury is required to conduct audits and investigations of the conduct of the Treasury in regard to the appointment of a receiver for a covered financial institution and the Treasury's participation in the funding of the resolution. Furthermore, the Inspector General of any Federal financial institution regulatory agency that supervised a covered financial company that is placed in receivership is required to prepare a report on the effectiveness of the agency's exercise of its supervisory responsibilities, to identify any actions or omissions of the agency that contributed to the company's condition, and any actions that could have been taken by the agency to prevent the company's failure. [§211]

2.17. Study on Secured Creditor Haircuts. The Oversight Council is required to conduct a study that evaluates the importance of maximizing taxpayer protections and promoting market discipline in regard to the treatment of fully secured creditors in connection with the utilization of orderly resolution authority. Among other matters, the Oversight Council is to examine how a haircut on secured creditors could improve market discipline and protect taxpayers. The Oversight Council is also to examine the behavior of creditors who are unsecured or under-collateralized and who seek collateral when a firm is failing, and the impact such behavior has on financial stability and an orderly resolution that protects taxpayers if the firm fails. The Oversight Council must provide a report to Congress on its findings and recommendations no later than 1 year after the enactment of the Act. [§215]

2.18. Study on the Bankruptcy Process for Large BHCs and Significant Nonbanks. The Fed, in consultation with the Administrative Office of the United States Courts, is required to conduct a study regarding the resolution of financial companies under the Bankruptcy Code. The issues to be considered in the study include the effectiveness of Chapters 7 and 11 in facilitating the orderly resolution or reorganization of Large BHCs and Significant Nonbanks, and whether the Bankruptcy Code should be amended to enhance the ability of the Bankruptcy Code to resolve financial companies. [§216]

**Title III**

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3. Title III – Transfer of Powers to the Comptroller of the Currency, the Corporation, and the Board of Governors. The Office of Thrift Supervision ("OTS") will be eliminated under Title III. The OTS's supervisory responsibilities (not including those transferred to the Bureau) will be allocated among the three Federal bank regulatory agencies. The Fed will assume responsibility for regulating savings and loan holding companies ("SLHCs"). The OCC will assume responsibility for Federal savings associations and the FDIC will have responsibility for State savings associations. The transfer of functions is generally expected to occur 1 year from the date of enactment of the Act. The Act continues the Federal savings association charter (both in mutual and stock form) and the powers and authorities of Federal savings associations under the Home Owners' Loan Act ("HOLA") without change except with respect to Federal law preemption of state consumer protection law (see Paragraph 10.22.).

In addition to provisions dealing with HOLA and the OTS, Title III also provides for a permanent increase of FDIC deposit insurance per depositor from $100,000 to $250,000. It also modifies elements of the deposit insurance assessment program, including increasing the minimum reserve ratio for the Deposit Insurance Fund from 1.15 percent to 1.35 percent, but requires the FDIC to offset the effect of the increase on institutions with assets of less than $10 billion. The mechanics of how the FDIC handles this differentiation are left to the FDIC to develop.

3.1 Transfer of OTS Functions. One year after the date of enactment of the Act the OTS's functions will be transferred ("Transfer Date") to the Fed, OCC or the FDIC. The Transfer Date may be extended by the Treasury Secretary until no later than 18 months after the enactment of the Act under certain circumstances.[§311] The OTS will be officially abolished 90 days after the Transfer Date.[§313]

3.1.2 Interim Operations. The OTS will work with the OCC, the FDIC, and the Fed to facilitate the orderly transfer of services and functions. [§321] Within 180 days of enactment of the Act, the four agencies must submit a joint plan to Congress detailing the steps the agencies will take to implement the transfer of functions.[§327]

3.2 Transfer of OTS Duties. The transfers of duties described below will take effect on the Transfer Date. [§312]

3.2.1 Federal Savings Associations Supervision to the OCC. The powers, authorities, and duties of the OTS related to Federal savings associations are transferred to the OCC. The transfer will include all functions relating to the Federal savings associations and all rulemaking authority of the OTS related to Federal savings associations. It also includes authority for the OCC to issue rules regarding State savings associations that will be supervised by the FDIC.[§312]

All orders, resolutions, determinations, agreements, interpretations, guidelines, procedures and advisory material issued by the OTS relating to Federal savings associations will remain in effect and shall be enforceable by or against the OCC, until modified, terminated, or superseded by the OCC, a court, or by operation of law. The OCC will publish a list of existing OTS regulations in the Federal Register that will be enforced by the OCC.. Any proposed OTS regulation relating to Federal savings institutions that has not been published as a final regulation before the Transfer Date will be deemed to be a proposed regulation of the OCC. Any interim or final regulation regarding Federal savings institutions published before the Transfer Date but that has not become effective before that date shall become effective as a regulation of the OCC unless modified, terminated, set aside or superseded by the OCC, by a court or by operation of law. The OCC will succeed to the OTS in all legal and enforcement actions related to Federal savings associations or any other function transferred to the OCC. [§316] The OTS staff associated with the supervision and chartering of Federal savings associations will be transferred to the OCC, afforded salary and job protection, and protected from discrimination based on origin of employment.[§322]

3.2.1.1 <u>Comptroller required to Name Deputy Comptroller Responsible for Federal Thrifts</u>. A new Deputy Comptroller position will be created on the Transfer Date. The new Deputy Comptroller will be appointed by, and report to, the Comptroller of the Currency, and will be responsible for the supervision and examination of Federal savings associations. [§314]

3.2.2 State Savings Associations Supervision to the FDIC. The powers, authorities, and duties of the OTS related to State savings associations are transferred to the FDIC. The transfer will include all functions of the OTS related to State savings associations, but will not include rulemaking authority.[§312] Existing OTS regulations and other actions and pending litigation relating to State savings associations will be treated in the same manner with respect to the FDIC as described above in regard to the OCC, except that rulemaking authority would be vested with the OCC.[§312]

3.2.3 SLHCs Supervision to the Fed. The powers, rulemaking authorities, and duties of the OTS related to SLHCs and their non-depository institutions subsidiaries are transferred to the Fed. Existing OTS regulations and other actions, pending litigation and proposed and not yet effective interim or final regulations relating to SLHCs and their non-depository institution subsidiaries will be treated in the same manner as described above in regard to the OCC.[§314]

3.2.4. Rulemaking Authority For Tying Arrangements and For Transactions With Affiliates and Insiders to the Fed. OTS rulemaking authority relating to transactions with affiliates and extensions of credit to insiders and relating to tying arrangements, is transferred to the Fed.[§312]

3.2.5. Staff Transfer. The OTS staff will be split between the OCC, the FDIC and the Bureau in proportion to functions transferred to these agencies. Most staff will transfer to the OCC because most savings association charters will be under OCC supervision.

3.3. *De Novo* Branching for Converted Savings Associations. Notwithstanding any provisions of Federal or state law, any savings association that converts to a bank may continue to operate existing branches or agencies. The association also may establish or acquire additional branches or agencies in states where the association previously operated, provided that banks chartered in that state are permitted to do so.[§341]

3.4 Revise Assessment Base for FDIC Insurance.

The FDIC deposit insurance assessment base, for an insured depository institution, will be redefined by the FDIC to an amount equal to:

- The average consolidated total assets of the insured depository institution during the assessment period; **minus**
  - The sum of:
    - The average tangible equity of the insured depository institution during the assessment period; **and**
    - In the case of an insured depository institution that is a custodial bank or a banker's bank, an amount that the FDIC determines is necessary to establish assessments consistent with the existing definition for a custodial bank or banker's bank. [§331]

The Act increases the minimum reserve ratio for the Deposit Insurance Fund from 1.15 percent to 1.35 percent of estimated insured deposits, or the comparable percentage of the assessment base. The FDIC must take steps necessary to reach the 1.35 percent reserve ratio by September 30, 2020. The FDIC, in establishing assessments necessary to reach this ratio, must offset the effect of the increase in the minimum reserve ratio on insured depository institutions with total consolidated assets of less than $10 billion.[§334] This should be beneficial to small banks but detrimental to larger banks. Importantly, the Act also removes the current cap (1.5 percent of estimated insured deposits) on the Deposit Insurance Fund's reserve ratio.

3.5 Insured Deposit Amount Permanently Increased to $250,000; Extension of Unlimited Insurance of Noninterest Transaction Accounts. The Act permanently increases from $100,000 to $250,000, the insured deposit amount per depositor. This amount also will apply retroactively to depositors in any institution for which the FDIC was appointed as receiver or conservator on or after January 1, 2008 and before October 3, 2008.[§335]

FDIC deposit insurance on the net amount in noninterest-bearing transaction accounts at an insured depository institutions is also extended for two additional years until December 31, 2012. [§343]

3.6 Elimination of Procyclical Assessments. The FDIC may, in its sole discretion, suspend or limit the mandatory annual payment of dividends from the Deposit Insurance Fund when the reserve ratio of the Fund exceeds 1.5. percent of estimated insured deposits. Currently, the FDIC must annually declare the amount in the Fund in excess of the amount required to maintain the reserve ratio at 1.5 percent of estimated insured deposits, as dividends to be paid to insured depository institutions. Additionally, the Act repeals the annual requirement that the FDIC must pay dividends to insured depository institutions when the Fund's reserve ratio is equal or greater than 1.35 percent and not more than 1.5 percent of estimated insured deposits. The FDIC must adopt regulations, after notice and comment, establishing the method for the declaring, calculating, distributing, and paying of dividends from the Deposit Insurance Fund.[§332]

3.7 Establishment of Office of Women and Minority Inclusion at Financial Regulatory Agencies and each Federal Reserve Bank. The Act requires that specified agencies, including, Treasury, the FDIC, the Fed, the OCC, the SEC, as well as the Federal Reserve Banks, specified will establish an Office of Minority and Women Inclusion that will be responsible for all matters of the agency relating to diversity in management, employment, and business activities. Each office will be established by 6 months from the enactment date, with the exception of the Office of Minority and Women Inclusion in the Bureau, which will be established by 6 months after the Transfer Date.

The agency administrator will appoint a Director of each Office. Each Director will develop standards for equal employment opportunity and workforce diversity and increased participation of minority-owned and women-owned businesses in the programs and contracts of the agency. Each Director will develop standards for assessing the diversity policies and practices of the entities regulated by the agency and advise the agency administrator on the impact of the policies and regulations of the agency on minority-owned and women-owned businesses.

The procedures established by each agency for review and evaluation of contract proposal and for hiring service providers shall include, to the extent consistent with applicable law, a component that gives consideration to the diversity of the applicant. These procedures must include a written statement that a contractor shall ensure, to the maximum extent possible, the fair inclusion of women and minorities in the workforce of the contractor. A contractor's failure to make a good faith effort to include minorities and women in its workforce may result in the termination of a contract, a referral to the Office of Federal Contract Compliance Programs, or other appropriate action.[§324]

**Title IV**

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4. Title IV – Regulation of Advisers to Hedge Funds and Others

Title IV sets forth new parameters for federal and state registration of investment advisers and:

- Introduces additional obligations relating to advisers to "private funds," which are defined as any issuer that would be an "investment company" (as defined in the Investment Company Act of 1940, as amended (the "1940 Act")) but for the exceptions to such status set forth in Sections 3(c)(1) and 3(c)(7) of the 1940 Act (i.e., most private equity funds, hedge funds, and venture capital funds); [§402(a)]
- Adjusts certain net worth requirements that private fund investors need to satisfy; and
- Commissions studies and reports relating to the private fund industry.

| Title IV will become effective one year after the date of its enactment. [§419] |
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4.1. Registration of Advisers to Private Funds. Title IV eliminates the 15 client "private adviser exemption" from federal registration under Section 203(b)(3) of the Investment Advisers Act of 1940, as amended (the "Advisers Act"), and creates new exemptions from registration for several categories of investment advisers. Title IV also modifies the exemptions on which certain private fund advisers relied upon in the past. Subject to certain exceptions set forth below, the elimination and modification of these exemptions will require many advisers to private funds to register.

> Exemptions from registration apply to a variety of advisers to private funds (e.g., banks acting as investment advisers, non-U.S. based advisers meeting certain conditions, advisers to family offices, advisers to venture capital funds, certain advisers to small business investment companies and smaller advisers). The exact rules governing advisers to family offices, venture capital funds, and smaller advisers are subject to future rulemaking by the SEC.

4.1.1. Preservation of Exemption for Banks and BHCs Acting as Investment Advisers. A bank or BHC, which is not an investment company or an investment adviser to a registered investment company, will remain exempt from registration as an investment adviser (even if they advise private funds) because Title IV continues to exclude them from the definition of "investment adviser" under the Advisers Act.

4.1.2. Exemption from Registration Applicable to Family Offices. An adviser to a "family office" is exempted from the definition of "investment adviser" under the Advisers Act and is accordingly exempted from the registration requirements thereunder. The SEC is to define the term "family office" in a manner (i) that is consistent with the previous exemptive orders granted to family offices; (ii) that recognizes the range of organizational, management and employment structures and arrangements employed by family offices; and (iii) that does not exclude certain advisers to family offices from such exemption solely because they were providing investment advice to certain specified persons prior to January 1, 2010. [§409]

4.2. Recordkeeping and Reporting Obligations. Title IV imposes new recordkeeping and reporting obligations on registered investment advisers that are advisers to private funds. These new requirements supplement those previously required under the Advisers Act. The SEC may require a registered private fund adviser (i) to maintain records and file with the SEC certain information relating to each private fund it advises and (ii) to provide or make available to the Oversight Council such information. [§404] This information shall include: (i) assets under management and use of leverage (including off-balance sheet leverage); (ii) counterparty credit risk exposure; (iii) valuation policies and practices; (iv) types of assets held; (v) side letters; (vi) trading practices; and (vii) such other information as the SEC, in consultation with the Oversight Council, may determine, which information may vary based on the type of investment adviser or the size of the private fund advised by the investment adviser. [§404]

The SEC shall be required to periodically examine all records maintained by registered advisers to private funds and shall be able to examine such records at such other times as it may determine. [§404] Any information filed with or provided to the SEC by a private fund adviser shall be made available to the Oversight Council and to any Federal department or agency or any self-regulatory organization. However, the SEC, the Oversight Council, and any such department, agency, or self-regulatory organization that receives such information from the SEC shall be required to keep it confidential. [§404] Within 12 months of the date of enactment of the Act, the SEC and the CFTC are required to jointly establish the form and content of the reports to be filed with the SEC and with the CFTC by private fund advisers that are registered with both the SEC and the CFTC. [§406]

4.3. Custody of Client Accounts. Registered investment advisers shall be required to take such steps to safeguard client assets over which such adviser has custody, including, without limitation, verification of the assets by an independent public accountant, as the SEC may require by regulation. [§411] In addition, the Comptroller General is required to conduct a study on the additional costs that would be incurred if SEC Rule 206(4)-2 subsection (b)(6) were eliminated – subsection (b)(6) currently provides an exception from the otherwise-required annual independent verification of the assets in a client's account where a related person to the adviser has custody of the client's assets, but such related person is operationally independent of the adviser. [§412] The results of such study stating the costs of eliminating the exception shall be submitted to Congress within 3 years of the date of enactment of the Act.

4.4. Increased Net Worth Thresholds for Private Fund Investors. The manner in which natural persons will qualify as investors in private funds will be modified in some respects. In addition, the SEC and the Comptroller General are required to conduct reviews or studies related to the net worth thresholds required of certain investors in private funds.

4.4.1. Adjustment of Accredited Investor Threshold. The net worth requirement for a natural person (or joint net worth with the spouse of that person) to qualify as an accredited investor under the Securities Act of 1933, as amended ("Securities Act") , shall exclude the value of the primary residence of such natural person and shall, for the 4-year period commencing on the date of enactment of the Act, be $1 million. At the end of such 4-year period, such net worth requirement must be in excess of $1 million. [§413] In addition, the SEC is authorized to undertake a review of the definition of the term "accredited investor" as such term applies to natural persons to determine whether the requirements of the definition (other than the net worth test mentioned above) should be adjusted or modified and, upon completion of the review, may adjust such requirements of the definition as it deems appropriate. Not earlier than the fourth anniversary of the enactment of the Act, and not less than once every 4 years thereafter, the SEC must undertake a review of the accredited investor definition in its entirety as it relates to natural persons and shall, upon the completion of each such review, adjust such requirements of the definition as it deems appropriate. [§413] In addition, the Comptroller General is required to conduct a study on the appropriate criteria for determining accredited investor status and eligibility to invest in private funds and shall submit a report to Congress on the results of such study within 3 years of the date of enactment of the Act. [§415]

4.4.2. Adjustment of Qualified Client Threshold. With respect to any dollar amount threshold used in determining whether a person is a "qualified client," the SEC shall be required no later than 1 year after the date of enactment of the Act, and every 5 years thereafter, to adjust for the effects of inflation on such test (rounding up to the nearest $100,000). [§418]

4.5. Comptroller General Study on SRO for Private Funds. The Comptroller General is required to conduct a study on the feasibility of creating a self-regulatory organization ("SRO") to oversee private funds and shall submit its report to Congress on the results of such study within 1 year of enactment of the Act. [§416]

4.6. SEC Study and Report on Short Selling. The Division of Risk, Strategy and Financial Innovation of the SEC is required to conduct a study on: (i) the state of short selling on national securities exchanges and over-the-counter ("OTC") markets (with particular focus on the impact of recent rule changes and the incidence of failure to deliver shares sold short or delivery of shares on the fourth day following the short sale transaction); (ii)(a) the feasibility of reporting publicly short sale positions of publicly-traded securities or, alternatively, filing such reports only to the SEC and Financial Institution Regulatory Agency ("FINRA"); and (ii)(b) the feasibility of a voluntary pilot program in which public companies agree to have all trades of their shares marked "short," "market maker short," "buy," "buy-to-cover," or "long" and reported in real time through the Consolidated Tape. The results of the study conducted under clause (i) immediately above must be submitted to Congress within 2 years of enactment of the Act while the results of the studies conducted under clause (ii) immediately above would need to be submitted within 1 year of enactment of the Act. [§417]

**Title V**

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5. Title V – Insurance. Title V creates the Federal Insurance Office ("Office"), a new Federal office charged with studying the insurance industry and reporting to Congress on recommendations concerning Federal regulation of insurance. Title V authorizes the Treasury Secretary and the United States Trade Representative ("Trade Representative") to negotiate international insurance agreements and implements reforms in state regulation of certain commercial insurance markets that modernize and bring uniformity to regulation in this area. Title V sets the stage for the Federal government to potentially play an increasingly significant role in the supervision of the insurance industry.

> Within 18 months, the Office must undertake a study on how to modernize and improve insurance regulation in the United States and report to Congress on its findings and recommendations. The Congressional mandate includes an examination of potential Federal regulation of insurance.

> The Treasury Secretary has general rulemaking authority to implement the Federal Insurance Office Act. The Office has access to personnel and other resources of the Treasury available to the Treasury Secretary.

5.1. What Entities are Impacted and How?

5.1.1. Impact of the Office. The Office does not have direct regulatory powers and is not charged with rulemaking. Nonetheless, the Office can be expected to have both short-term and long-term effects on insurance companies, their affiliates, and state insurance regulators. In the short term, the Office is directed to make a comprehensive study of the insurance industry, including the costs and benefits of Federal regulation, and in doing so may compel production of information from insurance companies and affiliates, subject to certain safeguards. The Office may also preempt actions by state regulators if they are inconsistent with international insurance agreements. In the long term, the greatest impact will occur if the Office recommends Federal regulation of the insurance industry, instead of the 50 state-system currently in place, and Congress implements that recommendation.

5.1.2. Impact of State Regulatory Reform. These provisions primarily affect state regulators and participants in the multi-state commercial insurance markets by imposing limitations and uniform provisions on a state's regulation of: (i) the sale of property and casualty insurance by insurers not admitted to conduct insurance business in the state, and (ii) reinsurance. Insurance companies and consumers in these markets are intended to benefit from a more efficient regulatory structure.

5.1.3. Impact of Other Provisions of the Act. It is important to note that insurance companies and their affiliates may also be substantially affected by many provisions of the Act other than Title V, depending on their business activities and whether they are affiliated with a bank or BHC. A few examples: (i) insurance companies or their affiliates may be designated as Significant Nonbanks or may be part of a Large BHC, either of which would be subject to heightened prudential regulation by the Fed; (ii) they may be governed by the Volcker Rule and regulation of derivatives trading (see Paragraph 6.20. for a discussion of the Volcker Rule); and (iii) the sale of insurance products that are considered securities may be affected by the standard of care applicable to broker-dealers and investment advisers that emerges from SEC rulemaking mandated by the Act. In addition, a provision known as the "Harkin Amendment" removes equity indexed annuities and certain other insurance products from the SEC's jurisdiction and will eliminate Federal regulatory burdens on issuers of these products and agents that sell them.

5.2. New Federal Insurance Office. There will be a new Federal Insurance Office within the Treasury. A Director appointed by the Treasury Secretary will serve as head of the Office. The Office does not have a regulatory function, but is charged with: (i) monitoring the insurance industry to enhance Federal understanding of insurance issues; (ii) gathering information and making recommendations to Congress about systemic risk and Federal regulation of insurance; (iii) supporting a Federal presence in negotiation of international insurance agreements; and (iv) making judgments about state preemption. [§502(a)/§313(c)]

5.2.1. Functions

5.2.1.1. Authority. The Office has authority to conduct a range of monitoring, coordinating, and other activities for all lines of insurance, except health insurance, crop insurance, and long term care insurance that is not included with life or annuity components. [§502(a)/§313(d)] These activities include, among others, the following: (i) monitoring all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the U.S. financial system; (ii) coordinating Federal efforts and developing Federal policy on prudential aspects of international insurance matters; (iii) determining whether state insurance regulations are preempted by international insurance agreements; (iv) consulting with the states regarding insurance matters of national importance and prudential insurance matters of international importance; and (v) recommend to the Oversight Council that it designate an insurer, including affiliates of such insurer, as a Significant Nonbank. [§502(a)/§313(c)(1)]

5.2.1.2. Advisory Responsibilities. The Director of the Office will serve in an advisory capacity on the Oversight Council. [§502(a)/§313(c)(3)] The Office will advise the Treasury Secretary on major domestic and prudential international insurance policy issues. [§502(a)/§313(c)(2)]

5.2.2. Information Gathering Powers

5.2.2.1. Information Review and Analysis. In carrying out its designated functions described above, the Office may: (i) receive and collect data, including financial data, on and from the insurance industry and insurers; (ii) enter into information-sharing agreements; (iii) analyze and disseminate data; and (iv) issue reports regarding all lines of insurance except health insurance. [§502(a)/§313(e)(1)]

5.2.2.2. Information Collection Power. The Office may require an insurer, or an affiliate of an insurer, to submit such data or information as the Office may reasonably require to carry out its designated functions, but only if the information is not available from other Federal agencies, state regulators, or publicly available sources. [§502(a)/§313(e)(2) and (4)] Submission of information to the Office will not constitute a waiver of privilege and will be subject to existing confidentiality provisions. [§502(a)/§313(e)(5)(A) and (B)]

5.2.2.3. Sharing Information with State Regulators. The Office may provide the information it collects to state insurance regulators through information-sharing agreements, provided that the agreements comply with applicable Federal law and do not constitute a waiver of or affect privilege under Federal or state law. [§502(a)/§313(e)(5)(C)]

5.2.2.4. Subpoena and Enforcement Power. The Director has subpoena power for production of information, but only if the Director makes a written finding that the information is required to carry out the Office's designated functions and that the Office has exhausted efforts to obtain the information from other agencies and public sources. [§502(a)/§313(e)(6)]

5.2.3. Preemption of State Insurance Measures

5.2.3.1. Standard and Scope of Preemption Authority. The Office has the power to preempt any state insurance regulation or action (state insurance measures) if and to the extent that the Director determines the state insurance measure: (i) results in less favorable treatment of a non-U.S. insurer subject to an international insurance agreement than a U.S. insurer domiciled, licensed, or otherwise admitted in the state; and (ii) is inconsistent with an international insurance agreement (an international insurance agreement is an agreement between the U.S. and one or more foreign governments that provides protections for consumers of insurance and reinsurance that are substantially equivalent to the protections provided under state law). [§502(a)/§313(f)(1)]

5.2.3.2. Procedural Requirements. Before making a preemption determination, the Director must follow certain prescribed procedures. The Director must: (i) notify and consult with the relevant state; (ii) notify and consult with the Trade Representative; (iii) publish notice of the issue in the Federal Register; (iv) provide interested parties a written opportunity to submit written comments; and (v) consider comments received. [§502(a)/§313(f)(2)] The Director must establish a reasonable period of time (at least 30 days) before the determination becomes effective and follow certain additional notice procedures once the determination has become effective. [§502(a)/§313(f)(3)]

5.2.3.3. Effect of Preemption. No state may enforce a state insurance measure to the extent the measure has been preempted under this provision. [§502(a)/§313(f)(4)]

5.2.3.4. Judicial Review of Preemption. Determinations of inconsistency with an international insurance agreement will be subject to the Administrative Procedure Act, except that in any action for judicial review of a determination of inconsistency, a federal court will determine the matter de novo. [§502(a)/§313(g)]

5.2.4. Reports to Congress.

5.2.4.1. Annual Reports. The Director must submit annual reports on: (i) the insurance industry and (ii) preemption, beginning September 30, 2011. [§502(a)/§ 313(n)]

5.2.4.2. Report on Reinsurance. The Director must submit to Congress: (i) a report describing the breadth and scope of the global reinsurance market and the critical role such market plays in supporting insurance in the United States by September 12, 2012; and (ii) a report describing the impact of the reinsurance provisions of the Act (described below under "State-Based Reform") on the ability of state regulators to access reinsurance information for regulated companies in their jurisdictions by January 1, 2013 and updated by January 1, 2015. [§502(a)/§313(o)]

5.2.5. Study and Report on Regulation of Insurance

5.2.5.1. Scope and Timing of Report. Within 18 months of enactment of the Act, the Director must conduct a study and submit a report on how to modernize and improve insurance regulation in the United States. [§502(a)/§313(p)(1)] The study and report is to be guided by the following considerations: (i) effective systemic risk regulation; (ii) capital standards and the relationship between capital allocation and liabilities, including standards relating to liquidity and duration risk; (iii) consumer protection for insurance products and practices, including gaps in state regulation; (iv) the degree of national uniformity of state insurance regulation; (v) the regulation of insurance companies and affiliates on a consolidated basis; and (vi) international coordination of insurance regulation. [§502(a)/§313(p)(2)] The Director must consult with state insurance regulators, consumer organizations, representatives of the insurance industry and policyholders, and other organizations and experts as appropriate. [§502(a)/§313(p)(5)]

5.2.5.2. Special Focus on Potential Federal Regulation of Insurance. The study and report must also examine a range of specified factors relating to the potential Federal regulation of the insurance industry. These include, among others, the costs and benefits of potential Federal regulation of insurance across various lines of insurance (except health insurance), the ability of potential Federal regulation to provide robust consumer protection for policyholders, and the potential consequences of subjecting insurance companies to a Federal resolution authority. [§502(a)/§313(p)(3)]

5.2.5.3. Required Recommendations. The study and report will also contain any legislative, administrative, or regulatory recommendations, as the Director determines appropriate, to carry out or effectuate the findings set forth in the report. [§502(a)/§313(p)(4)]

5.2.6. General Provisions

5.2.6.1. Rulemaking Authority of the Treasury Secretary. The Treasury Secretary (not the Office) has authority to issue orders, regulations, policies, and procedures to implement this section. [§502(a)/§313(h)]

5.2.6.2. Savings Provisions. The Act will not: (i) preempt any state insurance measure governing any insurer's rates, premiums, underwriting, or sales practices, state insurance coverage requirements, the application of any state antitrust laws to the business of insurance, or any state insurance measure governing the capital or solvency of an insurer, except to the extent the state insurance measure results in less favorable treatment of a non-U.S. insurer than a U.S. insurer; (ii) affect any provision of the Consumer Financial Protection Agency Act of 2010; or (iii) affect the preemption of any state insurance measure otherwise inconsistent with and preempted by Federal law. [§502(a)/§313(j)]

5.2.6.3. Retention of Existing State Regulatory Authority. The Act does not establish or provide the Office or Treasury with general supervisory or regulatory authority over the business of insurance. [§502(a)/§313(k)]

5.2.6.4. Retention of Authority of Federal Financial Regulatory Agencies. The Act does not limit the authority of any Federal financial regulatory agency, including the authority to develop and coordinate policy, negotiate, and enter into agreements with foreign governments, authorities, regulators, and multinational committees and to preempt state measures to affect uniformity with international regulatory agreements. [§502(a)/§313(*l*)]

5.3. Negotiation of International Insurance Agreements. The Treasury Secretary and the Trade Representative are jointly authorized to negotiate and enter into international insurance agreements on behalf of the U.S. [§502(a)/§314(a)] Before initiating negotiations for these agreements, during the negotiations, and before entering into an international insurance agreement, the Treasury Secretary and the Trade Representative must jointly consult with certain Congressional Committees. [§502(a)/§314(b)] An international insurance agreement "may enter into force" with respect to the United States only if: (i) the Treasury Secretary and the Trade Representative jointly submit to the Committees on a day on which both Houses of Congress are in session a copy of the final legal text of the agreement; and (ii) a period of 90 calendar days from the date of submission has expired. [§502(a)/§314(c)]

5.4. State-Based Insurance Reform. These provisions are designed to increase efficiency, reduce transaction costs, and improve customer access in the multi-state property and casualty insurance market and to reform the regulation of the reinsurance markets. The insurance activities that are the subject of these provisions were not identified as a cause of the financial crisis that gave rise to the Act in general. Rather the state-based insurance reform provisions reflect long-standing legislative efforts by the insurance companies and brokers that participate in these markets, which have now been swept into the general financial reform legislation. With certain exceptions, this Act takes effect 12 months after the date of enactment.

The provisions use the following terms: (i) "nonadmitted insurer" is an insurer not licensed to engage in the business of insurance in a state; (ii) "nonadmitted insurance" is property and casualty insurance placed with a nonadmitted insurer; and (iii) "surplus lines broker" is an individual or firm licensed in a state to sell insurance on properties or risks located in a state with nonadmitted insurers. [§527]

Within 30 months of enactment the General Accounting Office must complete a study and report to Congress on the effect of the Act on the size and market share of the nonadmitted insurance market for providing coverage typically provided by the admitted insurance market.

5.4.1. Nonadmitted Insurance

5.4.1.1. Reporting, Payment, and Allocation of Premium Tax. No state other than the home state of an insured may impose premium taxes on nonadmitted insurance, although states may enter into compacts or establish procedures for allocation of premium taxes paid to the insured's home state among the states subject to the compact or procedures. [§521]

5.4.1.2. Regulation of Nonadmitted Insurance by Insured's Home State. Placement of nonadmitted insurance is subject only to the statutory and regulatory requirements of the insured's home state. Only the home state may require a surplus lines broker to be licensed in order to sell, solicit, or negotiate nonadmitted insurance with respect to the insured. Any law, regulation, or action of any state that purports to apply to nonadmitted insurance sold to, solicited by, or negotiated with an insured whose home state is another state will be preempted with respect to such application. However, these restrictions do not apply to rules that restrict the placement of workers' compensation insurance or excess insurance for self-funded workers' compensation plans with a nonadmitted insurer. [§522]

5.4.1.3. Participation in National Producer Data Base. After two years from the date of enactment, a state may not collect fees relating to licensing of an individual or entity as a surplus lines broker in the state unless the state has in effect laws that provide for participation by the state in the national insurance producer database of the National

Association of Insurance Commissioners ("NAIC") for the licensure of surplus lines brokers and the renewal of such licenses. [§523]

5.4.1.4. Uniform Standards for Surplus Lines Eligibility. A state may not: (i) impose eligibility requirements for nonadmitted insurers domiciled in a U.S jurisdiction, except in accordance with nationwide uniform requirements; or (ii) prohibit a surplus lines broker from placing nonadmitted insurance with or procuring nonadmitted insurance from a nonadmitted insurer domiciled outside the United States if the broker is listed on the Quarterly Listing of Alien insurers maintained by the International Insurers Department of the NAIC. [§524]

5.4.1.5. Streamlined Application for Commercial Purchasers. A surplus lines broker seeking to procure or place nonadmitted insurance in a State for an exempt commercial purchaser will not be subject to certain state due diligence requirements, subject to certain disclosures and procedural requirements. [§525]

5.4.1.6. GAO Study and Report on Nonadmitted Insurance Market. The Comptroller General of the United States is directed to conduct a study of the nonadmitted insurance market to determine the effect of the Act on the size and market share of the nonadmitted insurance market for providing coverage typically provided by the admitted insurance market. In conducting the study, the Comptroller General will consult with the NAIC. The Comptroller General will complete the study and submit a report to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services not later than 30 months after the effective date of the Act. [§526]

5.4.2. Reinsurance

5.4.2.1. Regulation of Credit for Reinsurance and Reinsurance Agreements. No state may deny credit for reinsurance if the domiciliary state of a ceding insurer is an NAIC-accredited state, or has substantially similar financial solvency requirements as for NAIC accreditation, and recognizes credit for reinsurance for the insurer's ceded risk. Laws of a state that is not the domiciliary state of the ceding insurer (other than laws for taxes and assessments on insurance companies or insurance income) are preempted to the extent specified in the Act. [§531]

5.4.2.2. Regulation of Reinsurer Solvency. If the domiciliary state of a reinsurer is an NAIC-accredited state, the state will be solely responsible for regulating the financial solvency of the reinsurer. No other state may require the reinsurer to provide additional financial information, although the state may receive a copy of any financial statement filed with the home state. [§532]

# Title VI

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6. Title VI. Improvements to Regulation of Bank and Savings Association Holding Companies and Depository Institutions. Title VI contains the Volcker Rule, which severely limits the ability of certain bank and bank-related entities to engage in proprietary trading or invest in hedge funds and private equity funds. Title VI also strengthens the ability of banking agencies to regulate and supervise BHCs and SLHCs, and their non-depository institution subsidiaries, and requires consistent standards to be applied to the examination of bank permissible activities. The Title also places new restrictions on acquisitions that would result in a financial company controlling more than 10% of liabilities as defined in the Act, and requires Fed approval for a financial holding company to acquire a company with consolidated assets of

more than $10 billion. The Act also conditions acquisitions and expanded activities authority on achieving high standards of capital and management at the holding company level.

The Title amends Sections 23A and 23B of the Federal Reserve Act to make investment funds for which a bank serves as an investment adviser "affiliates" of the bank and adds several new types of transactions to the list of "covered transactions." The Title tightens lending limit provisions by deeming derivatives and repurchase agreements to be included in the definition of "extension of credit." The Title also seeks to limit "charter shopping" by placing conditions on the ability of troubled institutions to convert to a different type of charter.

Title VI also contains several provisions that increase the powers of financial institutions. Included among these provisions, are an express authorization for SLHCs to conduct the same activities as financial holding companies under certain conditions, the repeal of the prohibition on the payment of interest for business transaction accounts, and the removal of the restrictions on *de novo* interstate banking.

6.1. <u>Moratorium on New Nonbank Banks and on Change in Control of Nonbank Banks</u>. The Act seeks to fundamentally reexamine the current policy of allowing entities to control a depository institution without being deemed to be a BHC. The first prong of this approach is to provide that for a 3-year period from the date of enactment of the Act, the FDIC is not permitted to approve any applications for deposit insurance that were received after November 23, 2009, for any industrial bank, credit card bank, or trust bank (each a "nonbank bank") that is directly or indirectly owned or controlled by a "commercial firm." Moreover, during this period, the FDIC is not permitted to approve a change in control application with respect to a nonbank bank by a commercial firm.[§603] A company qualifies as a "commercial firm" if activities that are financial in nature (under Section 4(k) of the BHCA) comprise 15 percent or less of the annual gross revenues of the company and its affiliates combined.[§602]

6.1.1. Exceptions. The moratorium does not apply to applications with respect to the following situations, assuming the application otherwise would have been granted under applicable federal and state law: (i) nonbank banks determined by their primary federal regulator to be in danger of default; (ii) mergers or acquisitions of commercial firms directly or indirectly controlling the nonbank bank; or (iii) acquisitions of less than 25 percent of the voting shares of a publicly-traded commercial firm by a person or group of persons.[§603]

6.1.2. Study of Whether the Nonbank Bank and Savings Institution Exceptions Should Be Eliminated. The second prong of the reexamination of exemptions from BHC status is a study by the Comptroller General of the adequacy of the federal regulatory framework applicable to nonbank banks, savings associations, and credit unions and the potential consequences of subjecting these institutions to the requirements of the BHC Act.

> The Comptroller General must report to Congress within 18 months of enactment of the Act with respect to whether exceptions afforded to nonbank banks, savings associations and credit unions from the BHC Act serve to weaken the safety and soundness of these institutions or the financial system generally.

6.2. Enhanced Supervision of Holding Companies. The Act authorizes the primary regulator of a BHC or SLHC to regulate, examine and obtain reports from all subsidiaries of the holding company, including functionally regulated subsidiaries, effective on the Transfer Date (generally one year after the date of enactment of the Act). Provision is made for coordination with the other Federal and state regulators, and the holding company regulator is required to rely to the fullest extent possible on reports and other information available from sources other than the subsidiary, such as other federal regulators and publicly-available information.[§ 604]

6.3. Consideration of Risks to Banking and Financial System in Application Decisions. In another effort to address concerns regarding the potential impact of large institutions on financial stability, the Act provides that in addition to the other statutory factors that the appropriate Federal banking agency must consider when determining whether to approve a BHC application to acquire a bank or a Bank Merger Act transaction, the Federal bank regulatory agency will also be required to consider the extent to which granting the application would cause greater or more concentrated risk to the stability of the U.S. banking or financial system. These provisions are effective on the Transfer Date.

6.4. <u>Prior Approval Required for Financial Holding Companies to Acquire a Company with Consolidated Assets of More than $10 Billion.</u> The Act preserves the general ability of financial holding companies to engage in activities that have been deemed to be financial in nature without prior regulatory approval. However, if the commencement of such activities by a financial holding company will be through the acquisition of a company with consolidated assets of more than $10 billion, prior approval of the Fed will be required. This provision is effective on the Transfer Date.

6.5. <u>BHCs Required to be Well-Capitalized and Well-Managed to Become and Remain Financial Holding Companies.</u> A BHC will be required to be well capitalized and well managed before it may elect to become a financial holding company, and will be required to maintain that status in order to remain a financial holding company. Prior to these amendments, only depository institution subsidiaries of a BHC were required to meet these standards. This provision is effective on the Transfer Date.[§606(a)]

6.6. <u>Consistent Oversight of Depository Institution Holding Company Subsidiaries.</u> The Fed is required to examine all non-depository institution subsidiaries (other than a functionally-regulated subsidiary or a depository institution subsidiary) that engage in activities that are permissible for an insured depository institution, as if the activities were conducted in the lead insured depository institution subsidiary of the institution holding company. The purpose of this requirement is to ensure that bank-permissible activities are supervised and regulated in the same manner, without regard to whether they are conducted by a bank or by a nonbank holding company affiliate. The appropriate Federal banking agency for the lead depository institution subsidiary has backup authority examination and enforcement authority under certain circumstances if the Fed does not take action. The provisions relating to consistent examinations become effective on the Transfer Date.[§ 605]

6.6.1. Coordination with State Authorities. To the extent that a state authority examines the bank-permissible activities conducted in a nonbank subsidiary of a depository institution holding company, the Fed is required to coordinate with the state authority and may conduct joint or alternating examinations of the subsidiary.

6.7. SLHCs Empowered to Conduct the Same Activities as Financial Holding Companies. The Act expressly provides that if an SLHC meets the criteria to become a financial holding company, it may conduct the same activities as a financial holding company, subject to the same requirements and conditions applicable to financial holding companies. This provision is effective 1-year after the enactment of the Act.[§ 606]

6.8. Intermediate SLHC May be Required. The Fed may require a grandfathered unitary SLHC that conducts activities other than financial activities to conduct some or all of its financial activities (other than internal financial activities) through an intermediate SLHC. The Fed may order that an SLHC take such action not later than 90 days after the Transfer Date (subject to extension). The Fed will be required to order the creation of an intermediate SLHC if it determines that doing so is necessary to appropriately supervise the grandfathered unitary SLHC's financial activities and to ensure that its supervision does not extend to activities that are not financial in nature. Formation of an intermediate holding company will not affect adversely the grandfathered SLHC's grandfathered status or require a grandfathered SLHC to limit its activities.[§626]

6.8.1. Source of Strength. A grandfathered unitary SLHC must serve as a source of financial strength to its subsidiary intermediate holding company.

6.8.2. Fed Examination and Enforcement Authority. The Fed may examine a grandfathered unitary SLHC that controls an intermediate holding company. The Act provides that the Fed may take enforcement actions against the grandfathered unitary SLHC to ensure compliance with the intermediate holding company requirements.

> The Fed is required to promulgate regulations establishing criteria for determining whether to require the establishment of an intermediate holding company (no timetable is given). In addition, the Fed may promulgate regulations establishing restrictions or limitations on transactions between an intermediate holding company and its affiliates on one hand and the parent company and its affiliates on the other hand.

6.9. Stricter Requirements for Interstate Acquisitions. The Fed may not approve an interstate bank acquisition by a BHC unless the BHC is well capitalized and well managed. Prior to these amendments, the BHC merely was required to be adequately capitalized and adequately managed. Similarly, to approve an interstate bank merger, the appropriate federal banking agency must determine that the resulting bank will continue to be well capitalized and well managed after the transaction, rather than satisfying the current adequately capitalized and managed standards. These provisions are effective on the Transfer Date.[§607]

6.10. Nationwide Liability Concentration Limit for Acquisitions. Subject to the recommendations of the Oversight Council, a "financial company" is prohibited from merging or, consolidating with, or otherwise acquiring control of another company if the total consolidated liabilities upon the consummation of the transaction would represent more than 10 percent of the aggregate consolidated liabilities of all financial companies as of the end of the previous calendar year.[§ 622]. A financial company is (i) an insured depository institution; (ii) a BHC; (iii) a SLHC; (iv) any company that controls an insured depository institution: (v) a Significant Nonbank; and (vi) a foreign bank or company that is treated as a BHC.

For purposes of defining "liabilities," the Act distinguishes between U.S. financial companies and foreign financial companies. In the case of a U.S. financial company, liabilities equal (i) the total risk-weighted assets of the financial company, as determined under risk-based capital rules applicable to BHCs, adjusted to reflect exposures that are deducted from regulatory capital, less (ii) the total regulatory capital of the financial company under the risk-based capital rules applicable to BHCs. In the case of a foreign financial company, both components of the liability calculation are based on the U.S. operations of the company. The Act further provides that with respect to an insurance company or a Significant Nonbank, the Fed by rule will determine the assets of a company to provide for consistent and equitable treatment of such companies.

6.10.1. Exception to Concentration Limit. With the prior written consent of the Fed, the concentration limits will not apply to banks in default or in danger of default, acquisitions in which the FDIC is providing assistance, or that would only result in a *de minimis* increase in the liabilities of the acquiring company.

6.10.2. Oversight Council Study and Fed Regulations. Within six months of the passage of the Act, the Oversight Council is required to study the extent to which the concentration limit would affect financial stability, moral hazard in the financial system, the efficiency and competitiveness of U.S. firms, and the cost and availability of credit to consumers and businesses. The Oversight Council is directed to make recommendations regarding any modifications to the concentration limits that would more effectively implement the concentration limit of the Act.

The Fed must issue final rules implementing this provision which are to reflect recommendations from the Oversight Council within 9 months after the Council's study is complete. The Fed also may issue guidance to individual institutions or financial companies in general.

6.11. Interstate Mergers Prohibited where the Acquiror Would Control 10 Percent or More of U.S. Deposits. In addition to the liability concentration limits discussed above, the Act amends the Bank Merger Act to provide that the appropriate Federal banking agency may not approve an interstate merger if the resulting entity would control more than 10 percent of the total amount of deposits in the U.S. It also amends the BHC Act to provide that a BHC may not acquire a savings institution in a state other than the home state of the BHC if after the acquisition the BHC would control more than 10 percent of the total deposits of insured depository institutions in the U.S. These prohibitions do not apply to a transaction that involves an institution in default or in danger of default or with respect to which the FDIC provides assistance under Section 13 of the FDI Act.[§623]

6.12. Section 23A and 23B Coverage Expanded. The Act reflects Congressional concern regarding the risks to a bank from affiliate transactions that arise in the event of a failure of the affiliate. Congress was particularly concerned that existing law did not adequately address the potential impact of derivative transactions with affiliates.

The Act amends Section 23A of the Federal Reserve Act, which governs banks' loans to, purchases of assets from, and other transactions with affiliates, to include all investment funds for which a member bank or an affiliate of the bank serves as investment adviser, as an affiliate of the member bank.[§608] It also defines a purchase of assets subject to a repurchase agreement as an extension of credit, which subjects it to the collateral requirements of Section 23A. Under existing law, these transactions are covered transactions, but are not subject to collateral requirements. Additional transactions also are added to the definition of "covered transaction," as discussed below. The exemption for transactions with financial subsidiaries is eliminated.

6.12.1. New Types of Covered Transactions. Several types of transactions are added to the list of "covered transactions" under Section 23A, including: (i) the acceptance of debt obligations other than securities of an affiliate as collateral for a loan or extension of credit to a third party (acceptance of affiliate securities already is a covered transaction); (ii) a transaction with an affiliate involving the borrowing or lending of securities to the extent that the transaction causes the bank to have credit exposure to the affiliate; and (iii) a derivative transaction with an affiliate, to the extent that the bank will have credit exposure to the affiliate.

6.12.2. The Fed May Issue Regulations Defining "Credit Exposure" and Regarding the Treatment of Netting Arrangements. The term "credit exposure" is not defined in the Act. The Fed therefore may issue regulations or interpretations using existing rulemaking authority to define "credit exposure." Credit exposures on inter-affiliate derivative and securities lending or borrowing transactions are, to the extent they are collateralized by U.S. government securities and other high quality assets, exempt from Section 23A's quantitative and qualitative limitations. The Fed may also issue regulations or interpretations regarding how to treat netting arrangements in determining the amount of a covered transaction and whether it is fully secured.

6.12.3. New Procedures for Exemptions from 23A and B. The Act amends the Fed's authority to issue exemptions from Sections 23A and 23B, by conditioning that authority on the Fed's notification to the FDIC of its finding that the exemption is in the public interest and the absence of a written response from the FDIC within 60 days of notification that the FDIC finds the exemption poses an unacceptable risk to the Deposit Insurance Fund. The Act also authorizes the OCC by order to exempt a transaction of a national bank from the requirements of

Section 23A if the OCC and the FDIC jointly find the exemption is in the public interest and consistent with the purposes of Section 23A, and the FDIC finds that the exemption does not present an unacceptable risk to the Deposit Insurance Fund. The FDIC may exempt a transaction of a State nonmember bank if the FDIC and the Fed jointly find the exemption is in the public interest and consistent with the purposes of Section 23A, and the FDIC finds that the exemption does not present an unacceptable risk to the Deposit Insurance Fund. Similar provisions allow the OCC and the Fed to exempt transactions from the restrictions on transactions of federal savings institutions with affiliates, and the FDIC and the Fed to exempt transactions of state savings institution with affiliates.

6.12.4. Elimination of Exceptions for Transactions with Financial Subsidiaries. The Act prospectively eliminates the exception from quantitative limits on bank Section 23A covered transactions entered into with financial subsidiaries on or after the date of enactment of the Act, and the exclusion of financial subsidiary retained earnings from the calculation of bank investment in a financial subsidiary.[§ 609]

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| The provisions regarding affiliate transactions are effective 1 year after the Transfer Date. |

6.13. Stricter Lending Limits.

6.13.1. National Bank Lending Limits. The national bank lending limits will be revised to include any credit exposure to a person arising from a derivative transaction, a repurchase agreement, a reverse repurchase agreement, or a securities borrowing or lending transaction as extensions of credit subject to the lending limits. This provision will be effective 1 year after the Transfer Date.[§ 610]

6.13.2. State Lending Limit Treatment of Derivatives. A state bank may only engage in a derivative transaction if the state lending limit laws take into account credit exposure to derivative transactions. This provision will be effective 18 months after the Transfer Date.[§ 611]

6.14. Restrictions on Transactions with Insiders.

6.14.1. Expanded Lending Limits to Insiders. The statutory restrictions on extensions of credit to insiders implemented through the Fed's Regulation O will be expanded to take account of exposures arising from a derivative transaction, a repurchase agreement, reverse repurchase agreement, or a securities borrowing or lending transaction. This provision will become effective 1 year after the Transfer Date.[§614]

6.14.2. Limitations on Purchases or Sales of Assets With Insiders. The Act amends the FDI Act to provide that an insured depository institution may not purchase an asset from or sell an asset to an insider unless (i) the transaction is on market terms and, (ii) if the transaction involves more than 10 percent of the capital stock and surplus of the institution, there is an approval by a majority of the disinterested members of the board of directors of the institution. This provision takes effect on the Transfer Date. The Fed, in consultation with the OCC and FDIC, may adopt rules regarding this provision.[§ 615]

6.15. Restriction on Depository Charter Conversions by Troubled Institutions. In response to concerns that depository institutions have been able to reduce the level of regulatory scrutiny by switching charters and regulators, the Act restricts the ability of depository institutions to change their charters if they are subject to certain supervisory actions or orders. A charter change may still occur, if both the current and prospective chartering authorities approve the switch.[§ 612]

6.16. *De Novo* Branching into States. The Act continues the long running breakdown of barriers to interstate operations. It provides that if the law in the state in which a *de novo* branch is proposed to be located would permit the establishment of a bank branch by a state bank organized in that state, a national bank or state insured bank from a different state may establish a *de novo* branch in the new state.[§ 613]

6.17. Capital Requirements for BHCs and SLHCs and Insured Depository Institutions.

6.17.1. BHC and Depository Institution Countercyclical Capital Principles. In establishing capital requirements for BHCs and depository institutions the appropriate Federal banking agencies are directed to make capital requirements countercyclical – meaning that additional capital will be required in times of economic expansion, but less capital will be required during periods of economic downturn, consistent with the safety and soundness of the BHC. This approach is consistent with the direction of the Basel Committee to adopt less procyclical capital requirements.

6.17.2. SLHC Capital Requirements. SLHCs historically have not been subject to minimum statutory capital requirements. No longer will it be the case. The Act authorizes the Fed to issue SLHC capital requirements for SLHCs, which like the BHC's are to be countercyclical. This provision will operate in conjunction with Section 171 of the Act (the Collins Amendment) which will require SLHCs, subject to a general 5-year phase-in period, to meet capital requirements no less than those imposed on insured depository institutions.

6.18. Source of Strength Doctrine. The Act establishes a statutory mandate that the appropriate Federal banking agency require that a BHC or SLHC or other non-BHC or SLHC controlling an insured depository institution serve as a source of financial strength for the underlying bank or association. This is in addition to provisions requiring a grandfathered SLHC or a Significant Nonbank to be a source of strength to an intermediate holding company. The agencies are empowered to require the company serving as a source of strength to submit reports to the appropriate Federal banking agency regarding its financial health.[§ 616]

6.18.1. “<u>Source of Strength” Defined.</u> The Act defines “source of financial strength” to mean, “the ability of a company that directly or indirectly owns or controls an insured depository institution to provide financial assistance to such insured depository institution in the event of the financial distress of the insured depository institution.”

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| The Federal banking agencies are directed to issue joint rules to carry out the source of strength doctrine not later than 1 year after the Transfer Date, and the source of strength doctrine itself will be effective 1 year after enactment of the Act. |

6.19. <u>Securities Holding Company Supervision.</u>

6.19.1. <u>Elimination of SEC-Supervised Elective Investment Bank Holding Company Framework</u>. Nonbank securities firms will no longer be able to elect to become investment bank holding companies subject to SEC regulation. These provisions were in place to permit companies to elect to be supervised on a consolidated basis if required by foreign regulators. This framework is replaced by the new Securities Holding Company framework.[§ 617]

6.19.2. <u>Fed Supervised Securities Holding Companies</u>. If a securities firm owns or controls at least one registered broker-dealer and is required to be supervised on a consolidated basis, the firm will be permitted to elect to become a securities holding company supervised by the Fed.[§ 618]

6.19.2.1. <u>Fed Powers</u>. The Fed will have examination authority over securities holding companies and will be permitted to require these companies to submit reports and retain records. The Fed also is empowered to set capital and risk management standards for securities holding companies. In addition, enforcement provisions of the FDI Act and certain provisions of the BHC Act will apply to securities holding companies.

6.20. <u>The Volcker Rule</u>. Subject, to certain exceptions, the Volcker Rule prohibits banking entities from engaging in proprietary trading or acquiring or retaining any equity, partnership or other ownership interest in, or sponsoring, a hedge fund or private equity fund ("Fund").[§619] The Volcker Rule prohibitions are not to be construed, however, to limit or restrict the ability of a banking entity or a Significant Nonbank from selling or securitizing loans in a manner otherwise permitted by law.[§619(g)]

6.20.1. Banking Entities Covered by Volcker Rule Prohibitions. "Banking entity" is defined to mean: (i) an insured depository institution, other than certain limited purpose trust companies described below; (ii) a BHC or other company that controls an insured depository institution; (iii) a foreign bank or company that is treated as a BHC; and (iv) any affiliate or subsidiary of the foregoing.[§619(h)(1)]

6.20.1.1. Exception for Limited Purpose Trust Companies. Limited purpose nondepository trust companies are not included in the definition of "banking entity," and therefore are not subject to any of the restrictions of the Volcker Rule, unless they are treated as a Significant Nonbank. To qualify for this exception, a company must function solely in a trust or fiduciary capacity and all or substantially all of its deposits must be in trust funds received in a fiduciary capacity. In addition, the company must not (i) offer or market insured deposits by or through affiliates; (ii) accept demand deposits or deposits that may be withdrawn by check or similar means for payment to third parties; (iii) obtain payment or payment related services from the Fed; or (ii) exercise borrowing or discount privileges with the Fed.[§619(h)(1)]

6.20.2 Prohibited Proprietary Trading Activities. Proprietary trading means engaging as a principal for a party's own trading account in any transaction to purchase or sell, or otherwise acquire, or dispose of, any security, any derivative, any contract of sale of a commodity for future delivery, any option on such security, derivative, or contract, or any other security or financial instrument that the appropriate Federal banking agencies, the SEC or the CFTC may, by rule determine. A trading account is defined as an account used for acquiring or taking positions in these instruments principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements). [§619(h)(1), 619(h)(4)]

6.20.2.1. Permitted Proprietary Trading Activities. Notwithstanding the general prohibition on proprietary trading, a range of trading activities will be permitted, subject to certain limitations, including the absence of conflicts of interest and of certain financial risks:

- Purchases, sales, acquisitions, or dispositions of any of the following instruments: (i) U.S. government or agency obligations; (ii) obligations, participations or other instruments of or issued by the Government National Mortgage Association, Fannie Mae, Freddie Mac, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation, or a Farm Credit System institution; or (iii) state or municipal obligations;

- Purchases, sales, acquisitions, or dispositions of any security or other instrument "in connection with underwriting or market-making-related activities" if such activities "are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties";

- Hedging activities that are designed to reduce risks "in connection with and related to individual or aggregated positions, contracts, or other holdings of the banking entity";

- Purchases, sales, acquisitions, or dispositions of any security or other instrument on behalf of customers;

- Investments in small business investment companies, investments designed to promote the public welfare, or investments that are qualified rehabilitation expenditures with respect to certain historical structures;

- Purchases, sales, acquisitions, or dispositions of any security or other instrument by a regulated insurance company directly engaged in the business of insurance for the general account of the company, or by its affiliates if conducted in accordance with applicable state insurance law, regulations and written guidance, and the appropriate Federal banking agencies have not jointly determined that state law or guidance is insufficient to protect the safety and soundness of the banking entity or the financial stability of the U.S.;

- Proprietary trading solely outside of the U.S. conducted by a banking entity not controlled directly or indirectly by a U.S. banking entity; and

- Such other activity that the appropriate Federal banking agencies, the SEC and the CFTC determine, by rule, would promote and protect the safety and soundness of the banking entity and U.S. financial stability. [§619(d)(1)]

6.20.3. Limitations on Otherwise Permitted Proprietary Trading Activities. No transaction or activity may be deemed to be a "permitted activity" if it would: (i) involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties; (ii) result, directly or indirectly, in a material exposure to high risk assets or high risk trading strategies; (iii) pose a threat to the safety and soundness of such banking entity; or (iv) pose a threat to U.S. financial stability.[§619(d)(2)]

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| The Federal banking agencies and the SEC and CFTC are directed to issue regulations to implement the foregoing prohibitions. |

6.20.4 Investments in, and Sponsorship of, Hedge Funds and Private Equity Funds Limited. The Volcker Rule contains an exception to the general prohibition on investing in, or sponsoring, a Fund.[§619(a)(1)(B)] A Fund is generally defined by reference to those Funds that are exempt from registration under Sections 3(c)(1) and 3(c)(7) of the 1940 Act. [§619(h)(2)] A banking entity will be considered to sponsor a Fund by (i) serving as a general partner, managing member or trustee of the Fund; (ii) selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the directors, trustees or management of a Fund; or (iii) share with a Fund for corporate, marketing or other purposes, the same name or variant of a name.[§619(h)(5)]

6.20.4.1. Requirements for Organizing or Offering a Fund. A banking entity may organize or offer a Fund, including serving as a general partner, managing member or trustee and otherwise managing the Fund, if it meets all of the following requirements, including:

- The banking entity provides bona fide trust, fiduciary or investment advisory services to the Fund;

- The Fund is organized and offered only in connection with the provision of such services, and only to persons who are customers of such services of the banking entity;

- The banking entity does not acquire or retain any equity or ownership interest in the Fund other than the seed capital and *de minimis* investments described below;

- The banking entity, and its affiliates, comply with the certain prohibitions and restrictions on transactions with such Funds, as described below;

- The banking entity does not, directly or indirectly, guarantee, assume or otherwise insure the obligations or performance of the Fund, or any Fund in which such Fund invests;

- The banking entity does not share with the Fund, for corporate, marketing, promotional or other purposes, the same name or a variant of the same name;

- No director or employee of the banking entity takes or retains an equity interest, partnership interest or other ownership interest in the Fund, except for any director or employee who is directly engaged in providing investment advisory, or other services to the Fund;

- The banking entity discloses to prospective and actual investors in the Fund, in writing, that any losses in such fund are borne solely by investors in the Fund and not by the banking entity, and otherwise complies with any additional rules that the appropriate Federal banking agencies, the SEC and CFTC issue that are designed to ensure that losses in such Funds are borne solely by the investors in the Fund.[§619(d)(1)(G)]

6.20.4.2. <u>Limitations on Investment</u>. The Volcker Rule appears to permit banking entities to invest in a Fund only if such investment is in a Fund that the banking entity organizes and offers, and it does not appear to permit passive investments in Funds that are unrelated to the banking entity. The Volcker Rule establishes investment limits on an individual Fund basis and on an aggregate basis.

6.20.4.2.1. <u>Seed Capital Investments.</u> Subject to the overall limitation described below, a banking entity may invest in a Fund it organizes and offers for purposes of establishing the Fund and providing it with sufficient equity to attract unaffiliated investors.[§619(d)(4)(A)] In such a case, the banking entity must actively seek unaffiliated investors to reduce or dilute the banking entity's interests such that the banking entity will own no more than 3 percent of the Fund within a year of the Fund's launch.[§619(d)(4)(A)] A banking entity may apply to the Fed for an extension of up to 2 years to comply with this 3 percent requirement.[§619(d)(4)(C)]

6.20.4.2.2. Overall Limitations on Investment. A banking entity may not invest more than 3 percent of its Tier 1 capital in Funds at any time, or such lower percentage as determined by regulations issued by specified regulatory agencies.[§619(d)(4)(B)]

6.20.4.3. Investments in Funds by Non-U.S. Banking Entities Solely Outside of the US. A banking entity that is not directly or indirectly controlled by a U.S. banking entity may acquire or retain any equity, partnership or other ownership interest in, or sponsor a Fund solely outside of the U.S. pursuant to Section 4(c)(9) or 4(c)(13), provided that no ownership interest in the Fund is offered for sale or sold to a resident of the U.S.[§619(d)(1)(I)]

6.20.4.4. Other Fund Investments May be Permitted by Rule. It is possible that the appropriate Federal banking agencies, the SEC, and the CFTC may determine, by rule, to permit other investments in Funds if such investments would promote and protect the safety and soundness of the banking entity and U.S. financial stability.[§619(d)(1)(J)]

6.20.4.5. Activities with Respect to Funds are Subject to the Same Conflict of Interest/High Risk Limitations as Applicable to Proprietary Trading Activities. As with proprietary trading activities, no otherwise permissible activity with respect to Funds will be allowed if it would result in one of the prohibited conditions described in Paragraph 6.20.3. above.

6.20.5. Oversight Council Study of the Implementation of the Volcker Rule. Within six months after the enactment of the Act, the Oversight Council is to study and provide recommendations regarding the implementation of the provisions of the Volcker Rule ("Volcker

Study") with the intention of: (i) promoting and enhancing the safety and soundness of banking entities; (ii) minimizing the risk that insured depository institutions will engage in unsafe and unsound activities; (iii) limiting the inappropriate transfer of federal subsidies relating to deposit insurance and access to liquidity facilities from insured depository institutions to other institutions; (iv) reducing conflicts of interest between the interests of banking entities and Significant Nonbanks and the interests of their customers; (v) limiting activities that have caused undue risk or loss in the past or may be expected to create such risk in the future; (vi) allowing insurance companies to conduct insurance activities in accordance with applicable law, and consistent with the safety and soundness of any affiliated banking entity and of the U.S. banking system; and (vii) appropriately time the divestiture of illiquid assets that will be required as a result of the implementation of the Volcker Rule.[§619(b)(1)]

6.20.6. <u>Rulemaking.</u> Based in part on the recommendations of the Volcker Study, within 9 months after the completion of the Study, the appropriate Federal banking agencies, the Fed, the SEC, and the CFTC are required to adopt regulations to carry out the Volcker Rule. The regulators are required to coordinate to ensure that consistent regulations are adopted, and that the regulations do not favor or disfavor particular companies to which the regulations apply.[§619(b)(2)]

> The agencies are required to adopt regulations within 9 months after the Volcker Study is completed.

6.20.7. <u>Effective Date, Two Year Transition Period, Possibility for Further Extensions.</u> Generally, the Volcker Rule will go into effect the earlier of (i) 12 months after the date of the issuance of the final rules described above, or (ii) 2 years after enactment of the Act. [§619(c)(1)] Once the Volcker Rule becomes effective, banking entities will have 2 years to conform their activities to the Volcker Rule's requirements.[§619(c)(2)] The Fed may extend this period for up to three one year periods.[§619(c)(2)] The Fed is required to issue rules to implement the provisions regarding divestiture no later than 6 months after enactment of the Act.

6.20.7.1. Additional Divestiture Period for Illiquid Funds. A banking entity may apply for extensions to the extent necessary to comply with contracts in place as of May 1, 2010 in order to continuing to retain its equity, partnership or other ownership interest in an illiquid Fund. The Fed is authorized to issue rules regarding illiquid Fund status. In the case of an investment in an illiquid Fund, the Fed may grant one extension which may be up to 5 years in length.[§619(c)(3)] As above, the Fed is required to issue rules to implement the provisions regarding divestiture no later than 6 months after enactment of the Act.

6.20.7.2. Additional Capital During the Transition Period. On the same date as the agencies issues their general rules under the Volcker Rule, the agencies are to issue rules to impose additional capital requirements and any other restrictions deemed appropriate in regard to investments in Funds during the transition period.[§619(c)(5)]

6.20.8. Potential Increased Capital Requirements for Banking Entities Participating in Proprietary Trading or Fund Activities. If the appropriate Federal banking agencies, the SEC, and the CFTC determine that additional capital and quantitative limitations, including diversification requirements, are appropriate to protect the safety and soundness of banking entities engaged in permissible proprietary trading or Funds activities, these agencies are directed to issue regulations adopting these additional limitations.[§619(d)(3)]

6.20.8.1 Calculation of Capital for Purposes of Increased Capital Regulations. For purposes of determining compliance with any additional capital requirements imposed by the agencies as described in Paragraph 6.20.8.1. above, the aggregate amount of the outstanding investments by a banking entity, including retained earnings, is required to be deducted from the assets and tangible equity of the banking entity, and the amount of the deduction is required to increase commensurate with the leverage of the Fund in which the banking entity invests.[§619(d)(4)(B)(iii)]

6.20.9. Increased Capital Requirements for Significant Nonbanks. While banking entities are prohibited from engaging in certain proprietary trading and Fund-related activities these prohibitions do not apply to Significant Nonbanks. The Fed is, however, required to adopt rules requiring additional capital and additional quantitative limits, including diversification requirements, for Significant Nonbanks that engage in proprietary trading or acquire or retain any interest in, or sponsor a Fund.[§619(a)(2)]

6.20.10 Prohibitions and Restrictions Applied to Transactions between Banking Entities and Advised or Managed Funds. Banking entities that directly or indirectly serve as the investment manager, adviser, or sponsor to a Fund or organize or offer such a Fund (and any affiliates of such banking entities) may not engage in "covered transactions" with the Fund, as that term is defined in Section 23A of the Federal Reserve Act.[§619(f)(1)]

Under the Volcker Rule, Section 23B of the Federal Reserve Act will apply to the banking entity and affiliated funds to the same extent as if the banking entity were a member bank and the fund were an affiliate thereof. This provision would not prohibit transactions, such as service contracts, that would be subject to Section 23B, but rather would require them to be done on market terms.[§619(f)(2)]

6.20.10.1. Exceptions for Prime Brokerage. The Fed may permit a banking entity to enter into any prime brokerage transaction with a Fund in which a Fund managed, sponsored or advised by the banking entity has taken an equity interest if (i) the banking entity is in compliance with the Volcker Rule's requirements regarding a relationship with a Fund; (ii) the chief executive officer of the banking entity certifies in writing that the banking entity does not, directly or indirectly, guarantee or insure the obligations or performance of the Fund, or any Fund in which such fund invests; and (iii) the Fed determines that such transaction is consistent with the safe and sound operation and condition of the banking entity.[§619(f)(3)] Any approved prime brokerage activities will be subject to Section 23B of the Federal Reserve Act as if the counterparty were an affiliate of the banking entity. [§619(f)(3)(B)]

6.20.11. Compliance Requirements; Termination of Activities. The appropriate Federal banking agencies, the SEC, and the CFTC are required to issue regulations as part of the general Volcker Rule rulemaking process regarding internal controls and recordkeeping in order to insure compliance with the Rule.[§619(e)(1)] If a Federal banking agency, the SEC or CFTC has reasonable cause to believe that a banking entity or a Significant Nonbank has made an investment or engaged in an activity in a manner that functions as an evasion of the Volcker Rule or otherwise violates the Rule, the agency may take action to terminate the activity, after notice and an opportunity for a hearing.[§619(e)(2)]

6.21. Study of Bank Investment Activities. Within 18 months of the date of enactment of the Act, the appropriate Federal banking agencies are required to prepare a report on the activities that a banking entity may engage in under federal and state law, including under applicable interpretations and guidance. The study is to consider risks related to activities and investments and risk mitigation activities undertaken. The agencies must then provide a report to the Council, the House Financial Services Committee, and the Senate Banking Committee, including any recommendations with respect to whether additional restrictions on investment activities are warranted.[§ 620]

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| The agencies are to complete the study within 18 months of enactment of the Act and report to the Oversight Council and Congress within 2 months of the completion of the study. |

6.22. <u>One Year Prohibition on Conflicts of Interest in Securitizations.</u> An underwriter, placement agent, initial purchaser, or sponsor, or any affiliate thereof, of an asset-backed security (including a synthetic asset-backed security) may not engage in any activities that would involve or result in conflicts of interest within a year after the first closing date.[§ 621] This provision will not apply to (i) risk-mitigating or hedging activities, or (ii) purchases and sales consistent with liquidity obligations, and bona fide market-making in the asset backed security.[§ 621]

> The SEC is required to adopt rules implementing the prohibition against conflicts of interest within 270 days after the enactment of the Act. These rules and the statutory provision will be effective simultaneously.

6.23. <u>New Penalties for Violating the Qualified Thrift Lender Test.</u> If a savings association fails to become and remain a qualified thrift lender ("QTL"), it is immediately subject to certain restrictions and possible enforcement action. This is in contrast to the current HOLA provisions that require QTL failing savings associations to either become banks or become subject to certain restrictions. The Act provides that if a savings association fails the QTL requirement, the savings institution would be limited to paying only those dividends that would be permissible for a national bank, that are necessary to meet the obligations of any company that controls the savings association, and that are specifically approved by the OCC and the Fed.[§ 624]

6.24. <u>Treatment of Dividends by Certain Mutual Holding Companies</u>. This set of provisions grandfathers those mutual holding companies ("MHCs") that waived dividends prior to December 31, 2009, and does not require those waived dividends to be included in the exchange ratio in the event of a second stage conversion. The provisions generally continue the OTS requirements on dividend waivers for those institutions covered by the grandfathering although it is unclear how they will be administered by the Fed going forward. The provisions do not permit MHCs that had not waived dividends prior to December 1, 2009, to waive any dividends going forward.[§ 625]

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| The provisions regarding mutual holding company dividends are effective 1 year after the enactment of the Act. |

6.25. Interest-Bearing Transaction Accounts Authorized. The prohibition on payments of interest on demand deposit accounts for businesses by banks or savings associations is repealed, effective 1 year after the enactment of the Act.[§ 627]

**Title VII**

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7. Title VII – Regulation of Over-the-Counter Swaps Markets. Title VII establishes a new regulatory framework for the OTC derivatives markets, with particular focus on:

- Prohibiting the Fed or the FDIC from providing Federal assistance to insured depository institutions involved in the swaps markets, as swap dealers, subject to exceptions for certain types of swaps activities, but allowing a broad range of swaps activities by a non-bank affiliate of an insured depository institution in a holding company organization, subject to certain restrictions;
- Requiring clearing and exchange trading for derivatives contracts that are eligible for clearing and accepted by newly established derivatives clearing organizations;
- Imposing new capital and margin requirements and various reporting obligations on OTC swap dealers ("swap dealers") and most large OTC swap participants ("major swap participants"); and
- Requiring swap dealers and most major swap participants, depending on whether their derivatives business involves securities or commodities, to register with the SEC or the CFTC (together the SEC and the CFTC are referred to as the "Commissions").

For ease of reference, the terms “swap,” “swap dealer” and “major swap participant” will be used to include, respectively, the terms “security-based swap,” “security-based swap dealer” and “major security-based swap participant,” unless the context otherwise distinguishes the terms.

7.1. Prohibition Against Federal Government Bailouts of Swaps Entities (the “Swap Push-out Rule”). The initial version of the Swap Push-out Rule, as proposed by Senator Blanche Lincoln (D-AR), generally prohibited banks active in the swaps markets from receiving various forms of “Federal assistance,” including Federal deposit insurance and access to the Fed discount window or any Fed credit facility. After considerable debate the scope of the compromised version of the Swap Push-out Rule has been significantly narrowed. The final legislative text of the Swap Push-out Rule prohibits providing “Federal assistance” only to depository institutions that constitute “swaps entities” and also contains several important exemptions for qualifying insured depository institutions. [§716]

7.1.1. What Depository Institutions are Affected by the Swap Push-out Rule? Under the rule, Federal assistance may not be provided to any “swaps entity with respect to any swap, security-based swap, or other activity of the swaps entity.” Federal assistance is defined as the use of any advances from any Federal Reserve credit facility or discount window (that is not part of a facility with broad-based eligibility under Section 13 of the Federal Reserve Act), or FDIC insurance or guarantees for the purpose of (i) making any loan to, or purchasing any stock, equity interest, or debt obligation of, any swaps entity; (ii) purchasing the assets of any swaps entity; (iii) guaranteeing any loan or debt issuance of any swaps entity; or (iv) entering into any assistance arrangement, loss sharing, or profit sharing with the swap entity.

A "swaps entity" is any swap dealer or major swap participant that is registered with the CFTC or SEC, but does not include any major swap participant that is also an insured depository institution.

A "swap dealer" is a newly created category under the Act defined as an entity that (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. The swap dealer definition contains a proviso, however, that states that 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. Taken as a whole, the swap dealer definition would appear to permit a depository institution that operates a traditional lending business, together with limited and related swap activities, to continue these functions without being affected by the Swap Push-out Rules.

A "major swap participant" is another newly created category under the Act defined as a person: (i) who maintains a "substantial position" in swap transactions, excluding positions held for hedging or mitigating the participant's commercial risk (commonly referred to as "commercial end users") and positions held by employee benefit plans; (ii) whose outstanding swaps create "substantial counterparty" exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or (iii) who is a financial entity that (A) is "highly leveraged relative to the amount of capital it holds, and that is not subject to capital requirements established by an appropriate Federal banking agency" and (B) maintains a substantial position in outstanding swaps transactions.

As noted above, the term “swaps entity” does not include any major swap participant that is an insured depository institution. Accordingly, an FDIC-insured depository institution would only be a “swaps entity” if it were a swap dealer.

However, the reach of section 716 could also impact insured depository institutions by preventing them from using depository institution funds to do any of the enumerated activities that qualify as “Federal assistance”, such as purchasing a debt obligation of a “swaps entity,” or guaranteeing a loan or debt issuance of a “swaps entity.”

7.1.2. <u>What other Exemptions are Available from the Swap Push-out Rule</u>? An FDIC-insured depository institution will not be subject to the prohibition on Federal assistance if its swap activities are limited to (i) hedging and other similar risk mitigating activities directly related to the insured depository institution’s activities; (ii) acting as a swaps entity for swaps involving rates or reference assets permissible for investment by a national bank under 12 U.S.C. 24; and (iii) acting as a swaps entity for credit default swaps that are cleared by a derivatives clearing organization or a clearing agency.

In addition, the term “swaps entity” does not include any insured depository institution under the FDI Act or a covered financial company under Title II which is in conservatorship, receivership or a bridge bank operated by the FDIC.

7.1.3. <u>Can a Depository Institution Permissibly Establish an Affiliate to Operate as a Swaps Entity</u>? Yes, Title VII’s prohibition on Federal assistance does not apply to, and does not prevent an FDIC-insured depository institution from establishing and maintaining, an affiliate that is a swaps entity, provided that the following conditions are satisfied: (1) the depository institution is part of a BHC or SLHC that is supervised by the Fed, and (2) the affiliated swaps entity complies with Sections 23A and 23B of the Federal Reserve Act and any other requirements that the CFTC, SEC and the Fed may determine necessary.

7.1.4. Prohibition on Use of Taxpayer Funds to Prevent Receivership of Swaps Entities. The Act prohibits the use of taxpayer funds for preventing (i) the receivership of any insured depository institution swaps entity; (ii) the receivership of any Significant Nonbank swaps entity; or (iii) the orderly liquidation of non-FDIC insured, non-systemically significant institutions. However, if a swaps entity constituting (a) an insured depository institution or (b) a Significant Nonbank is placed in receivership, its swap activity will be subject to termination or transfer in accordance with applicable law. All funds used in the termination or transfer or swap activity of any swaps entity are to be recovered through the disposition of assets or through assessments, including assessments on "the financial sector."

7.1.5. What Additional Rulemaking is Required Under the Swap Push-out Rule? The prudential regulators are charged with prescribing rules and setting standards to permit swaps entities to conduct their swap activities in a safe and sound manner and to mitigate systemic risk. Banks and BHCs may not become swaps entities unless they conduct their business in compliance with such rules and minimum standards.

In prescribing these rules, the prudential regulators are required to consider: (i) the expertise and managerial strength of the swaps entity, including systems for effective oversight; (ii) the financial strength of the swaps entity; and (iii) systems for identifying, measuring and controlling risks arising from the swaps entity's operations, the swaps entity's participation in existing markets and participation and entry into new markets and products.

7.1.6. When Does the Swap Push-out Rule Go Into Effect? Generally, two years after the effective date of these provisions of Title VII, which is 360 days after the date of enactment of the Act. In addition, if an insured depository institution qualifies as a "swaps entity" and therefore is ineligible for Federal assistance, the applicable Federal bank regulator with jurisdiction over the institution will give the institution up to a 24-month transition period to divest the swaps entity or cease the activities that require registration as a swaps entity, plus the possibility of a one-year extension. In establishing the appropriate transition period for any such divestiture or cessation of derivatives-related activities, the applicable Federal bank regulatory agency will take into account the potential impact on the bank's (1) mortgage lending, (2) small business lending, (3) job creation and (4) capital formation versus the potential negative impact on insured depositors and the FDIC's Deposit Insurance Fund.

7.1.7. How Does the Swap Push-out Rule Address Existing Swaps a Bank Entered Into Before Enactment of the Act? Insured depository institutions that have entered into swaps before the expiration of the transition period in which the institution must divest itself of the swaps entity (two years, plus a possible additional one year), do not have to unwind the existing swaps to continue to receive Federal assistance. Swaps entered into before the expiration of the bank's transition period are not affected by the prohibitions in Section 716.

7.2. Jurisdiction over OTC Derivatives. In addition to the Swap Push-out Rule, Title VII of the Act provides a comprehensive framework for the regulation, clearing, and exchange-trading of OTC derivatives.

7.2.1. What OTC Derivatives are Covered? The Act defines a "swap" broadly to cover most commonly traded OTC derivatives, including options on interest rates, currencies, commodities, securities, indices and various other financial or economic interests or property; contracts in which payments and deliveries are dependent on the occurrence or non-occurrence of certain contingencies (e.g., a credit default swap), and swaps on rates and currencies, total return swaps, and various other common swap transactions. [§721]

The Act provides for an analogous set of definitions for "security-based swaps," which are generally swap transactions involving a single security or loan or narrow-based security index. In broad terms, the CFTC will have jurisdiction over swaps and the SEC will have analogous jurisdiction over security-based swaps.

7.2.2. Are Foreign Exchange Swaps and Forwards Still Excluded from CFTC and SEC Jurisdiction? Foreign exchange ("FX") swaps and forwards will be considered "swaps" and subject to regulation under the Act unless the Treasury Secretary determines that such transactions should not be regulated under Title VII and have not been structured to evade the reach of the legislation. Banks, dealers, and other institutions have traditionally been the primary participants in the FX swaps and forwards markets. These markets have been exempt from regulatory oversight since a 1974 Treasury Department request (the so-called "Treasury Amendment") not to burden these participants with unnecessary regulation. It is uncertain at this time whether the Treasury Secretary will determine that FX swaps and forwards should not be subject to Title VII. [§721]

7.3. Impact on Banks and Dealers.

7.3.1. What Types of Banks and Dealers are Covered? Under Title VII, banks, dealers and other financial institutions active in the derivatives markets may be considered "swap dealers" and subject to registration and record-keeping requirements. As noted above, a swap dealer is defined as 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. [§721]

Title VII includes a substantially similar definition for a "security-based swap dealer," which deals primarily in security-based swap transactions.

Unknown at this point is what may constitute a person "hold[ing] itself out as a dealer in swaps" or purchasing or selling swaps in the "ordinary course of business." Title VII does not task the Commissions with defining these terms.

7.3.2. Can Banks and Dealers Engage in Swap Activities Without Being Deemed a "Swap Dealer"? Yes, the entities below will not be deemed swap dealers in the following circumstances: (i) an insured depository institution to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer; (ii) an entity that buys or sells swaps for such person's own account, either individually or in a fiduciary capacity, and not as "part of a regular business;" and (iii) an entity that engages in a "de minimis quantity" of swap dealing in connection with transactions with or on behalf of its customers. The CFTC and SEC are charged with promulgating regulations to establish factors in making the determination of a "de minimis quantity." [§721]

7.3.3. What are the Consequences of Being a Swap Dealer? Each swap dealer is required to register with the CFTC or SEC depending on whether such swap dealer's derivatives business involves swaps or security-based swaps. The Commissions are charged with developing the form and manner of such registration. Swap dealers will also be required to submit on-going reports containing such information relevant to the swap dealer's business as the Commissions may require. [§731]

Commission rules must provide for the registration of swap dealers not later than 1 year after the date of enactment of the Act. Note, however, that Section 754 of the Act states that the provisions of the Act shall take effect on the later of 360 days after enactment of the Act or, to the extent a provision in the Act requires rulemaking, not less than 60 days after publication of the final rule implementing such provision.

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| The CFTC and SEC will each determine for swap dealers and security-based swap dealers the form and manner of the registration applicable to be filed with the applicable Commission. The CFTC and SEC will further determine what information will be required to be submitted to the applicable Commission on an on-going basis. |

7.3.4. What are the new Regulatory Capital and Margin Requirements for Swap Dealers? In the event a swap dealer is registered with one or both Commissions, each such swap dealer for which there is a prudential regulator, such as the Fed or the FDIC, must meet new minimum capital standards and initial and variation margin requirements for uncleared swaps as required by such prudential regulator. For any swap dealer for which there is no prudential regulator, such capital standards and margin requirements will be set by the applicable Commission. [§731]

In terms of the amount of any such additional regulatory capital required, the Act mandates that such amounts must help ensure the safety and soundness of the swap dealer and be appropriate for the risk associated with the uncleared swaps held by the swap dealer.

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| The applicable prudential regulators, in consultation with the SEC and CFTC, shall jointly adopt rules for swap dealers, with respect to their activities as swap dealers, for which there is a prudential regulator imposing capital requirements and both initial and variation margin requirements on all Swaps that are not cleared by a derivatives clearing organization ("DCO"). |

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| The SEC and CFTC shall adopt rules for swap dealers, with respect to their activities as swap dealers, for which there is no prudential regulator imposing capital requirements and both initial and variation margin requirements on all swaps that are not cleared by a DCO. |

7.3.5. What Reporting and Record-keeping Obligations do Swap Dealers face? Swap dealers will be required to provide reports to the Commissions regarding the transactions and positions and financial condition of the swap dealer. Daily trading records will need to be maintained and all related records, recorded communications (such as email, instant messaging and recorded telephone calls) for such period of time as the Commissions may require. A swap dealer will also be required to maintain books and records of all activities related to its business as a swap dealer in such form and manner and for such period of time as the Commissions may require. Such books and records must be available for inspection by the relevant Commission, the Department of Justice, appropriate Federal banking agencies, and other regulators. Swap dealers will further be required to maintain a complete audit trail for conducting comprehensive and accurate trade reconstructions. [§731]

7.3.6. What Business Conduct Standards Will Apply to Swap Dealers? Each registered swap dealer will be required to satisfy business conduct standards adopted by the Commissions that will: (i) establish a duty for a swap dealer to verify that any counterparty meets the eligibility standards for an eligible contract participant; (ii) require disclosure by the swap dealer to any counterparty to a transaction of (a) information related to the material risks and characteristics of the swap transaction; (b) any material incentives or conflicts of interest that the swap dealer may have in connection with the swap transaction; (c) for cleared swaps, upon the request of the counterparty, receipt of a daily mark of the transaction from the appropriate DCO; and (d) for uncleared swaps, receipt of a daily mark of the transaction from the swap dealer; (iii) establish a duty for a swap dealer to communicate in a fair and balanced manner based on principal of fair dealing and good faith; and (iv) establish such other standards and requirements as the Commissions may determine are appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. [§731]

7.3.7. What Special Requirements do Swap Dealers Face when acting as Advisors to Special Entities? A swap dealer that acts as an advisor to a governmental plan or entity, employee benefit plan or endowment, referred to as a "Special Entity," must adhere to a higher standard of conduct and act in the best interests of such Special Entity. For example, a swap dealer that acts as an advisor to a Special Entity must make 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, including such information relating to the Special Entity's financial status, tax status, investment or financing objectives and any other information that the Commissions may prescribe. [§731]

7.3.8. What Special Requirements do Swap Dealers Face as Counterparties to Special Entities? A swap dealer that acts as a counterparty to a governmental plan or entity, employee benefit plan or endowment, referred to as a "Special Entity," must adhere to any duty established by the Commission that requires the swap dealer to have a reasonable basis to believe that the special entity has an independent representative that i) has sufficient knowledge to evaluate the transaction and risks; ii) is not subject to statutory disqualification; ii) is independent of the swap dealer; iv) undertakes a duty to act in the best interests of the counterparty it represents; v) makes appropriate disclosures; vi) will provide written representations regarding fair pricing and the appropriateness of the transaction; and vii) in the case of employee benefit plans, is a fiduciary. [§731]

7.4 Scope of Jurisdiction over Major Swap Participants and Commercial End Users.

7.4.1. What is a Major Swap Participant? Under Title VII, market participants other than swap dealers active in the derivatives markets may be considered "major swap participants" and subject to registration and record-keeping requirements. As noted above, a "major swap participant" is defined as a person: (i) who maintains a "substantial position" in swap transactions, excluding positions held for hedging or mitigating the participant's commercial risk (commonly referred to as "commercial end users") and positions held by employee benefit plans; (ii) whose outstanding swaps create "substantial counterparty" exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or (iii) who is a financial entity that (A) is "highly leveraged relative to the amount of capital it holds, and that is not subject to capital requirements established by an appropriate federal banking agency" and (B) maintains a substantial position in outstanding swaps transactions. [§721]

Title VII includes a substantially similar definition for a "major security-based swap participant," or a person that has swap positions in securities-based swap transactions.

Title VII excludes from the major swap participant definition any entity whose primary business is providing financing, and which uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90% or more of which arise from financing that facilitates the purchase or lease of products, 90% or more of which are manufactured by the parent company or another subsidiary of the parent company.

7.4.2. What is a "Substantial Position" in Swap Transactions? The Commissions are required to define "substantial position" as the amount the Commissions determine prudent for the effective monitoring, management, and oversight of market participants that are systemically important or can significantly impact the financial system of the United States.

However, there is no indication as to whether the "substantial position" will be determined across affiliated entities, such as across multiple funds advised by a single manager, or whether it will be determined on a person-by-person basis (e.g., long positions against short positions within a single portfolio). While earlier iterations of the legislation were silent on the whether margin is relevant to this analysis, Title VII states that the Commissions may take into account the value and quality of collateral held against counterparty exposure. [§721]

The determination of what will constitute "substantial counterparty exposure" is also unclear. While a hedge fund may have $100 million in outstanding swaps facing an individual dealer, a $100 million counterparty exposure to a dealer with a $1 trillion balance sheet – i.e., 1% of the dealer's assets – might not be considered "substantial."

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| The SEC and CFTC are required to issue regulations defining "substantial position" as the amount each Commission determines is prudent for the effective monitoring, management and oversight of market participants that are systemically important or can significantly impact the financial system of the United States. |

7.4.3. What Regulatory Capital and Margin Requirements will apply to Major Swap Participants? Major swap participants will face largely similar regulatory capital requirements as swap dealers. A major swap participant for which there is a prudential regulator must meet new minimum capital standards and initial and variation margin requirements for uncleared swaps as required by such prudential regulator. For any major swap participant for which there is no prudential regulator, such capital standards and margin requirements will be set by the applicable Commission. [§731]

It is important to note that on June 30, 2010, Chairmen Dodd and Lincoln sent a letter to Chairman Frank and Peterson, stating that, "Congress clearly stated in this bill that the margin and capital requirements are not to be imposed on end-users, nor can the regulators require clearing for end-user trades. . . . In cases where a Swap Dealer enters into an uncleared swap with an end-user, margin on the dealer side of the transaction should reflect the counterparty risk of the transaction." This letter also recognizes that the capital and margin requirements in the bills *could* have an impact on existing swap contracts, but clarifies that the provisions in the bill giving legal certainty to those contracts currently in existence provides that "no contract could be terminated, renegotiated, modified, amended or supplemented (unless otherwise specified in the contract) based on the implementation of any requirement in this Act, including requirements on Swap Dealers and Major Swap Participants."

> The applicable prudential regulators, in consultation with the SEC and CFTC, shall jointly adopt rules for major swap participants, with respect to their activities as major swap participants, for which there is a prudential regulator imposing capital requirements and both initial and variation margin requirements on all swaps that are not cleared by a DCO.

> The SEC and CFTC shall adopt rules for major swap participants, with respect to their activities as major swap participants, for which there is no prudential regulator imposing capital requirements and both initial and variation margin requirements on all swaps that are not cleared by a DCO.

7.4.4. <u>What Reporting and Record-keeping Obligations Will Apply to Major Swap Participants?</u> As with swap dealers, major swap participants will be required to provide reports to the Commissions regarding the transactions and positions and financial condition of the major swap participant. Daily trading records will need to be maintained and all related records, recorded communications (such as email, instant messaging and recorded telephone calls) for such period of time as the Commissions may require. Major swap participants, like swap dealers, will also be required to maintain books and records of all activities related to its business as a major swap participant, in such form and manner and for such period of time as the Commissions may require. Major swap participants will further be required to maintain a complete audit trail for conducting comprehensive and accurate trade reconstructions. [§731]

7.4.5. Do Major Swap Participants Face New Business Conduct Standards? Yes, major swap participants, like swap dealers, will face additional business conduct standards in respect of their swap counterparties. Major swap participants will also be required to assume heightened responsibilities when dealing with counterparties that are "Special Entities," which include governmental plans and entities, retirement plans and endowments. [§731]

7.4.6. How does the Act Affect Commercial End Users? Commercial end users are counterparties to swaps that are not financial entities which are using such swaps to hedge or mitigate commercial risk. The legislation specifically provides that the Commissions shall consider whether to exempt small banks, savings associations, farm credit system institutions, and credit unions from the definition of a "financial entity". This exclusion could include depository institutions with total assets of $10,000,000,000 or less. In addition, if a swap is required to be cleared (as discussed below) and one party to the swap is a commercial end user, that party may choose not to clear the swap. As noted above, commercial end users will also be exempt from the definition of a major swap participant. [§723]

The legislation does explicitly provide commercial end-users with the option to clear swap contracts, the option to choose their clearinghouse or clearing agency, and the option to segregate margin with an independent third-party custodian (see below).

7.5. Clearing Requirements.

7.5.1. What are the Clearing Requirements for Swaps? Title VII requires clearing of all swap transactions that are acceptable to a DCO for clearing, other than, as noted above, any swaps for which one of the counterparties is a commercial end-user. A DCO must submit to the SEC or CFTC for prior approval any group, category, type, or class of swaps the DCO seeks to clear. The relevant Commission must respond to any such DCO request within 90 days of the submission of the request. [§723]

DCOs are required to treat all swaps (but not commodity futures or options thereon) submitted to the DCO with the same terms and conditions as economically equivalent within the DCO and able to be offset with each other. DCOs are further required to provide for non-discriminatory clearing of a swap (but not a commodity future or option thereon) executed bilaterally or on or through the rules of an unaffiliated contract market or swap execution facility ("SEF").

7.5.2. What are the Requirements to Qualify as a DCO? Clearing of swaps is a cornerstone of the derivatives reform legislative agenda. Accordingly, to be registered and to maintain registration as a DCO, a DCO must meet an extensive set of criteria, with the most important criteria being: (i) each DCO must have adequate financial, operational and managerial resources, as determined by the CFTC or SEC, respectively; (ii) each DCO must possess financial resources that, at a minimum, exceed the total amount that would (a) enable the DCO to meet its financial obligations to its members and participants, notwithstanding a default by the member or participant creating the largest financial exposure for that DCO in "extreme but plausible market conditions;" and (b) enable the DCO to cover the costs of the DCO for a one-year period; (iii) on an on-going basis, each DCO must establish and implement procedures to verify the compliance of each participation and membership requirement of the DCO; (iv) each DCO must (a) not less than once during each business day, measure the credit exposures of the DCO to each member and participant of the DCO, and (b) monitor each such exposure periodically during the business day of the DCO; (v) through margin requirements and other risk control measures, each DCO must limit the exposure of the DCO to potential losses from default by members and participants of the DCO; (vi) each DCO must have rules and procedures designed to allow for the efficient, fair, and safe management of events in the event of a member or participant insolvency; and (vii) with respect to conflicts of interest, each DCO must establish and enforce rules to minimize conflicts of interest in the decision-making process of the DCO. [§725]

7.5.3. Can Parties Enter into Swaps that are not Cleared? Yes, parties to a swap that is not accepted by a DCO will be required to report the swap to a "swap data repository" or "SDR." [§723]

7.5.4. What is a Swap Data Repository or "SDR"? An SDR is generally any person that collects, calculates, and prepares information or records related to transactions or positions in, or the terms and conditions of, swaps entered into with third parties. [§728] The data collection and data maintenance standards for SDRs will be determined by the SEC and CFTC. Swaps entered into before the enactment of the Act will be required to be reported to an SDR within 30 days of issuance of an interim final rule on the reporting of swaps, which in turn must be promulgated by the SEC and CFTC within 90 days of the effective date of the Act. [§729]

7.5.5. Are Existing Swap Transactions Required to be Cleared? No, swaps entered into before the date of enactment of Title VII are exempt from the clearing requirements provided these swaps are reported to a SDR. [§723]

7.6. Exchange Trading of Swaps

7.6.1. What Swaps are Required to be Traded on an Exchange? Title VII mandates that a swap that is cleared on a DCO must be traded on a board of trade designated as a "contract market" (i.e., a futures exchange) or a SEF. [§723]

7.6.2. What is a "Swap Execution Facility"? A SEF is a facility in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by other participants in the facility or system through any means of interstate commerce. Given that the initial exchange trading of swaps is likely to be relatively illiquid, it is unclear whether swap participants will be required to transact directly with the relevant exchange or if participants may contact dealers off the exchange to initiate a transaction, provided that the execution of the swap prints on the relevant exchange. [§733]

7.7. Rulemaking on Conflicts of Interest

7.7.1. What Safeguards are in place to Mitigate Conflicts of Interest in DCOs, SEFs and Contract Markets? Title VII requires that, within 180 days after the date of effectiveness of the Act, the Commissions must adopt rules that may include numerical limits on the control of, or the voting rights with respect to, any DCO that clears swaps, or SEF or contract market that posts swaps or makes swaps available for trading by a BHC with total consolidated assets of $50 billion or more, a Significant Nonbank, an affiliate of such a BHC or Significant Nonbank, a swap dealer, a major swap participant or associated persons of a swap dealer or major swap participant. [§726]

In adopting the foregoing rules, the Commission must consider any conflicts of interest arising from the amount of equity owned by a single investor, the ability to vote, cause the vote of, or withhold votes entitled to be cast on any matters by the holders of the ownership interest, and the governance arrangements of any DCO, SEF or contract market.

The SEC and CFTC are required to issue rules within 180 days of the effectiveness of Title VII to mitigate potential conflicts between owners of DCOs, SEFs and contract markets.

7.8. Public Reporting of Swap Transaction Data.

7.8.1. Will Swap Transaction Data be Publicly Available? Yes, the Commissions are required to provide by rule for the public availability of the following swap transaction and pricing data:

(1) With respect to cleared swaps, the Commissions will require real-time public reporting for such transactions, which will include price and volume as soon as technologically practicable after the time at which the swap transaction has been executed; and

(2) With respect to uncleared swaps that are reported to a SDR, the Commissions will require real-time public reporting of transactions but only in a manner that does not disclose the business transaction and market positions of any person.

With respect to the rules providing for the public availability of swap transaction and pricing data, the rules promulgated by the Commissions must contain provisions that:

(1) Ensure such information does not identify the participants;

(2) Specify the criteria for determining what constitutes a large notional swap transaction for particular markets and contracts;

(3) Specify the appropriate time delay for reporting large notional swap transactions to the public; and

(4) Take into account whether the public disclosure will materially reduce market liquidity. [§727]

The SEC and CFTC are required to issue rules providing for the public availability of swap transaction and pricing data.

7.8.2. What Swap Transaction Information will the Commissions Publish? The Commissions are required to issue a written report on a semi-annual basis, which will be available to the public, relating to the trading and clearing in the major swap categories and the market participants and developments in new products. [§727]

7.9. Segregation of Client Funds.

7.9.1. What Segregation Protections must Swap Dealers Provide for Cleared Swaps? All monies, securities or property from, for, or on behalf of a swap customer to margin, guarantee or secure a swap cleared by or through a DCO or a clearing agency (for security-based swaps) must be held with a futures commission merchant ("FCM"), or a broker, dealer, or security-based swap dealer (for security-based swaps) . The FCM, broker, dealer, or security-based swap dealer must separately account for and must not commingle customer property with its own funds. However, notwithstanding the foregoing, any such customer property may be commingled and deposited in the same account with any bank, trust company or DCO/clearing agency. [§724]

7.9.2. What are the Segregation Requirements for Uncleared Swaps? A swap dealer or major swap participant must notify a counterparty at the beginning of a swap transaction that the counterparty has the right to require segregation of the funds or other property supplied to margin, guarantee, or secure the obligations of the counterparty.

At the request of the counterparty, the swap dealer or major swap participant must segregate the funds of other property and maintain such funds or other property in a segregated account separate from the assets of the swap dealer or major swap participant. Such segregated account must be carried by an independent third-party custodian and designated as a segregated account for and on behalf of the counterparty. The foregoing segregation requirements, however, do not apply to variation margin payments.

7.10. Extraterritorial Jurisdiction of the CFTC and SEC. If the CFTC or SEC determines that the regulation of swaps or security-based swaps in a foreign jurisdiction undermines the stability of the United States financial system, the CFTC or SEC, as applicable, in consultation with the Treasury, may prohibit an entity domiciled in such foreign jurisdiction from participating in the United States derivatives markets. [§715]

**Title VIII**

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8. Title VIII – Payment, Clearing, and Settlement Supervision. Consistent with the systemic focus and risk-based approach of Title I, Title VIII establishes a framework for a systemic approach to ensuring the stability of the payment, clearing and settlement systems. In Title VIII Congress has given broad discretion to Federal regulators to determine what measures are necessary to ensure the sound functioning of these systems.

Title VIII has two principal prongs. The first prong addresses parties that operate or manage multilateral systems for the purpose transferring, clearing, or settling payment, securities, or other financial transactions among or financial institutions or between financial institutions and the system operator. These system operators are referred to as financial market utilities ("Utilities"). It is clear that these parties will be subject to enhanced regulation and supervision.

The second prong of Title VIII involves financial institutions that participate in the payments, clearing or settlement system ("Participants"). The impact of Title VIII on Participants is not at all clear at this point. It will ultimately depend on three principal factors:

- First, whether a particular payment, clearing, settlement system will be deemed to be systemically important;

- Second, what threshold of activity will be established to subject Participants to regulation as a result of their role in a systemically important system ("Covered Participants");

- Third, what types of requirements will be imposed on a Covered Participant.

In the case of Title VIII, determinations made by regulators and the rulemaking process will play a critical role in deciding the ultimate impact of the broad mandate that has been given to Federal regulators in protect the stability of payment, clearing and settlement systems on Utilities and Participants.

8.1 Designation of a Utility or Activity as Systemically Important.

8.1.1 Selection Procedure. The Oversight Council will be responsible for designating (i) Utilities, or (ii) payment, clearing, or settlement activities ("Activity"), that the Council determines are, or are likely to become, systemically important. A designation must be approved by a two-thirds vote and may be rescinded by a two-thirds vote.

The Council will give notice to a Utility proposed for designation. In the case of an Activity proposed for designation, the Council will publish notice of the proposed designation in the Federal Register. A Utility proposed for designation, or a financial institution engaged in a proposed designated Activity, may request an opportunity for a hearing before the Council to demonstrate that the proposed designation or rescission of a designation is not supported by substantial evidence. Before making any determination, the Council is required to consult with the relevant Supervisory Agency. The relevant Supervisory Agency is the Federal agency that has primary jurisdiction over a designated Utility: the SEC in regard to a Utility that is a clearing agency registered with the SEC, the CFTC in regard to a Utility that is a DCO registered with the CFTC, the appropriate Federal banking agency with respect to a Utility that is an insured depository institution, or the Fed with respect to a Utility that is not subject to the jurisdiction of any of the foregoing agencies. [§ 804]

8.1.2 Selection Criteria. In determining whether a Utility or an Activity is, or is likely to become, systemically important, the Council must take into consideration, among other things: (i) the total monetary value of transactions processed by the Utility or carried out through the Activity; (ii) the total exposure of the Utility or a financial institution engaged in payment, clearing, or settlement activities to its counterparties; (iii) the relationships, interdependencies, or other interactions of the Utility or Activity with other Utilities or payment, clearing, or settlement activities; and (iv) the effect that the failure of or a disruption to the Utility or the Activity would have on critical markets, financial institutions, or the broader financial system.

8.1.2.1 Utilities. The term "Utility" as defined in Section 8. above, does not include designated contract markets, registered futures associations, swap data repositories, and swap execution facilities registered under the Commodity Exchange Act. It also does not include national securities exchanges, national securities associations, alternative trading systems, security-based swap data repositories, and SEFs registered under the Securities Exchange Act of 1934 ("Exchange Act"). These exclusions apply only to the activities that require the entity to be so registered. The term Utility does not include any broker, dealer, transfer agent, or investment company, or any FCM, introducing broker, commodity trading advisory, or commodity pool operator solely as a result of functions performed in connection with the furnishing by the Utility of its services to its Participants or the use of the services of the Utility by its Participants, provided that the such entity do not constitute critical risk management or processing functions of the Utility. [§ 803]

8.1.2.2 Financial Activity. A payment, clearing, or settlement activity is an activity carried out by 1 or more financial institutions to facilitate the completion of financial transactions. A financial transaction includes: (i) funds transfers, (ii) securities contracts, (iii) repurchase agreements, (iv) derivatives contracts, and (v) FX contracts. A financial transaction does not include any offer or sale of a security under the Securities Act or any quotation, order entry, negotiation, or other pre-trade activity or execution activity. [§ 803]

8.1.2.3. Financial Institution. A financial institution includes a insured depository institution, a broker or dealer, an investment, an insurance company, an investment adviser.

8.2 Prudential Standards.

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| As a general matter, the Fed, by rule or order, will issue risk management standards for designated Utilities and designated Activities. |

The Fed may take into consideration international risk management standards and existing prudential requirements in setting standards. These standards will govern: (i) the operations related to the payment, clearing, and settlement activities of designated Utilities; and (ii) the conduct of designated Activities by financial institutions.

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| The CFTC and the SEC may each issue regulations containing risk management standards, subject to override by the Fed and the Oversight Council. |

The objectives and principles for the risk management standards established by regulation will be to: (i) promote robust risk management; (ii) promote safety and soundness; (iii) reduce systemic risk; and (iv) support the stability of the broader financial system. [§ 805]

8.2.1 Scope. The risk management standards established by regulation may address areas including: (i) risk management policies and procedures; (ii) margin and collateral requirements; (iii) participant or counterparty default policies and procedures; (iii) the ability to complete timely clearing and settlement of financial transactions; and (iv) capital and financial resource requirements for designated Utilities.

8.2.2. Thresholds for Standards. It is important to note that prudential standards for the Activities conducted by financial institutions, may be subject to a threshold as to the level or significance of engagement in the of the Activity at which a financial institution will become subject to the standards in regard to that activity. This provision gives the Fed significant authority to exempt a large portion of financial institutions from prudential standards with regard to a particular Activity.

8.3 Access to Fed Discount Window and Similar Borrowing Privileges. In a tool intended to promote financial stability, the Fed (by an affirmative vote of a majority of the board) may extend to a designated Utility access to Federal Reserve discount and borrowing privileges in unusual or exigent circumstances. The designated Utility must show that it is unable to secure adequate credit accommodations from other banking institutions. The Fed may prescribe limits on all such discount and borrowing privileges. [§ 806]

8.4 Supervision. In a significant provision for the operation of designated Utilities, such an entity must provide notice to its Supervisory Agency 60 days in advance of any proposed change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the designated Utility.

> Each Supervisory Agency, in consultation with the Fed, will issue regulations that define and describe the standards for determining when notice is required to be provided.

The notice of a proposed change must include: (i) the nature of the change and expected effects on risks to the designated Utility, its Participants, or the market; and (ii) how the designated Utility plans to manage any identified risks.

The Supervisory Agency may require a designated Utility to provide any information necessary to assess the effect the proposed change would have on the nature or level of risks associated with the designated Utility's payment, clearing, or settlement activities and the sufficiency of any proposed risk management techniques. The Supervisory Agency will notify the designated Utility of any objection within 60 days of the latter of the date that notice is received or the date any further information requested for consideration of the notice is received. The review may be extended for an additional 60 days for proposed changes that raise novel or complex issues.

A designated Utility may not implement a change if the Supervisory Agency has notice of an objection.

A designated Utility may immediately implement a change if an emergency exists and immediate implementation is necessary for the Utility to continue providing its services in a safe and sound manner. Emergency notice must be given within 24 hours of the change. [§ 806]

8.4.1 Examination and Enforcement Regarding Designated Utilities. The Supervisory Agency will conduct examinations of a designated Utility at least annually. The Supervisory Agency may also examine a service provider for a designated Utility if it provides services that are integral to the operation of the Utility. The Fed will have backup examination authority. The Supervisory Agency will have the same enforcement authority under Section 8 of the FDI Act over the designated Utility as it would if the Utility was an insured depository institution and the Supervisory Agency was the appropriate Federal banking agency for such institution. The Fed is given backup enforcement authority under certain circumstances. [§ 807]

8.4.2. Examination and Enforcement Regarding Participants. The appropriate financial regulator is authorized to examine a financial institution with regard to matters under Title VIII. The appropriate financial regulator will have the same enforcement authority under

Section 8 of the FDI Act over the financial institution as it would if the institution was an insured depository institution and the appropriate financial regulator was the appropriate Federal banking agency for such institution. The Fed is given backup enforcement authority under certain circumstances. [§ 807]

8.5. Oversight Council Information Requests. The Oversight Council is authorized to require any designated Utility to submit whatever information the Council may require for the sole purpose of assessing whether that Utility is systemically important. The request may only be made if the Council has reason to believe that the Utility meets the standards for systemic importance.

The Oversight Council is also authorized to require any financial institution to submit whatever information the Council may require for the sole purpose of assessing whether any payment, clearing, or settlement activity engaged in or supported by the financial institution is systemically important. The request may only be made if the Council has reason to believe that the Activity meets the standards for systemic importance. [§ 809]

8.6. Other Information Requests. The Fed and the Oversight Council may each require a designated Utility to submit reports or data to the Fed and the Oversight Council in order to assess the safety and soundness of the Utility and the systemic risk it poses to the financial system. The Fed and the Oversight Council may also require one or more financial institutions subject to a prudential standard in regard to a designated Activity to submit reports or data to the Fed or the Oversight Council with respect to the Activity.

8.7. Rulemaking Authority. The Fed and the Supervisory Agencies and the Oversight Council are authorized to issue rules and orders as necessary to carry out their authorities and duties under Title VIII and to prevent evasions of the Title. [§810]

8.8. Effective Date. The title becomes effective on the date of enactment of the Act. [§814]

American Bankers Association | Dechert LLP

# Title IX


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9. Title IX – Investor Protections and Improvements to the Regulation of Securities.

Title IX contains a broad set of initiatives intended to improve (i) investor protection in a variety of areas; (ii) securities disclosures, including disclosures regarding executive compensation and asset-backed securities; and (iii) securities enforcement, including improvements to the timeliness of the enforcement process.

Title IX also seeks to address areas that have been identified as contributing to the 2008-2009 financial crisis. Among other things, it imposes risk retention requirements in connection with certain asset-backed securities and by reforming the regulation of credit rating agencies.

The risk retention provisions are likely to have a significant impact on the operations of depository institutions and their affiliates. Federal regulators will have substantial discretion to tailor the implementing regulations to address the nature of the assets involved and the underwriting characteristics of the underlying assets in a particular securitization.

9.1. Investor Protection Initiatives. The Act attempts to improve the effectiveness of the SEC's efforts at investor protection. It establishes an Investor Advisory Committee charged with providing the SEC with investor perspectives and recommendations.[§911] It also establishes an Office of Investor Advocate that will be charged with assisting investors and recommending regulatory changes to protect investors.[§915]

9.2. SEC Studies and Rulemaking. The Act requires a wide range of studies intended to identify potential improvements in investor protection, and SEC functions and management. It also authorizes the SEC to issue rules governing broker-dealer relationships with customers and implementing the recommendations of the various studies.

9.2.1. Fiduciary Duty and Duty of Care of Brokers, Dealers and Investment Advisers to Customers. The Act gives the SEC authority to establish a fiduciary duty standard of care for broker-dealers providing personalized investment advice to a retail customer. It does so by directing the SEC to study the effectiveness of existing standards of care regarding personalized investment advice to retail investors, to identify gaps in protection for investors, and to recommend any necessary changes. The SEC is authorized to adopt the same standard for broker-dealers providing personalized investment advice to retail customers as investment advisers are currently subject to under the Investment Advisers Act. The standard was described in the Supreme Court's decision in *SEC v. Capital Gains Research Bureau*. The SEC is also authorized to issue rules to facilitate disclosures of conflicts of interest, to prohibit or restrict certain sales practices, conflicts of interest and compensation, and to require notice of limited proprietary offerings. [§913]

In conducting the study, the SEC is directed to consider SEC and Financial Institution Regulatory Authority ("FINRA") enforcement resources; substantive differences in broker-dealer and investment adviser advice; state legal standards; the effect on customer access to products and services from imposing an Advisers Act standard of care; the effect of imposing an investment adviser's standard of care on broker-dealers; authorizing the SEC to designate a self-regulatory organization to oversee investment advisers; eliminating the broker-dealer exclusion from the definition of investment adviser; the varying levels of service provided by brokers, dealers and investment advisers; and the benefits and harms from changes.

> The SEC study is due 6 months from enactment of the Act. SEC rulemaking to implement conclusions and recommendations of the study is to commence 2 years after enactment of the Act.

9.2.2. SEC Study of Investor Financial Literacy. The SEC is directed to study investor financial literacy, methods to improve the timing, content and format of disclosures, methods to increase the transparency of expenses and conflicts of interest in connection with financial services and mutual funds, and the most effective existing private and public investor education efforts. The SEC study is due 2 years after enactment of the Act.[§917]

9.2.3. Comptroller General Study of Mutual Fund Advertising. The Comptroller General is directed to study mutual fund advertising to identify existing and proposed regulatory requirements for mutual fund advertising, current mutual fund marketing practices including use of performance information, merged funds and incubator funds, the impact of fund advertising on consumers, and recommendations to improve investor protections. The Comptroller General's study is due 18 months after enactment of the Act. [§918]

9.2.4. Comptroller General Study of Potential Conflicts of Interest Within Firms. The Comptroller General is directed to conduct a study of potential conflicts of interest between the investment banking, equity and fixed income analyst functions within a firm and make recommendations for the protection of investors. The Comptroller General's study is due 18 months after enactment of the Act.[§919A]

9.2.5. Comptroller General Study on Securities Litigation. The Comptroller General is directed to conduct a study on the impact of authorizing a private right of action against anyone who aids or abets another in violating the securities laws. The Comptroller General's study is due 1 year after enactment of the Act. [§929Z]

9.2.6 SEC Rulemaking for Paying Agents of Missing Security Holders. The SEC is directed to revise its rules governing missing security holders to require that any paying agent (issuer, transfer agent, broker-dealer, custodian and others) with respect to such a security must provide a written notice to the missing security holder that a check (of at least $25) sent to the security holder has not been negotiated. The notice must be sent within 7 months after the original check was sent. The SEC is required to adopt rules within 1 year of enactment of the Act. [§929W]

9.2.7 Reports to SEC on Cancelled Securities. The Act amends the lost and stolen securities reporting provisions of the Exchange Act to require banks, broker-dealers, and others to report cancelled securities to the SEC in addition to lost, stolen, and counterfeit securities. [§929D]

9.3. Streamlined Self Regulatory Organization Rulemaking. The Act seeks to speed up the regulatory process by requiring the SEC to act on Self Regulatory Organization ("SRO") rule proposals within 45 days, either approving or instituting procedures to determine whether the proposal should be disapproved, or if the SEC fails to act, the rule proposal will be deemed to have been approved, subject to certain exceptions.[§916]

9.4. SEC Point of Sale Rulemaking Authority. The Act clarifies the SEC's authority to adopt rules requiring broker-dealers to provide documents or information to customers before the purchase of a product or service. Document form and contents are mandated to be in summary format and to disclose investment objectives, strategies, costs, risks, and compensation or incentives to the intermediary.[§919]

9.5. Enforcement. The Act requires the SEC to speed up the enforcement process and expands the authority of the SEC to enforce the securities laws by, among other things, authorizing the SEC to limit mandatory arbitration of securities disputes; providing incentives and protections to whistleblowers; allowing the SEC to serve subpoenas nationwide; and expanding the authority of the SEC and the United States to prosecute violations of the securities laws.

9.5.1. Imposition of Deadlines. The Act establishes new deadlines for the SEC to complete enforcement investigations, examinations and inspections. Within 180 days after the Staff of the Enforcement Division issues a Wells Notice, the SEC is required to file an enforcement action or justify why it is not filing one, unless exceptional circumstances warrant an extension of the deadline, in which case successive 180-day extensions may be obtained with appropriate notice and approval. Similarly, within 180 days after having completed the on-site portion of a compliance examination or inspection, or after having received documents from an entity being examined or inspected, whichever is later, the SEC is required to provide the subject entity with written notice of the SEC's resolution of the examination or inspection, unless an examination or inspection involves a particularly complex issue, in which case one 180-day extension may be obtained with appropriate notice. [§929U]

9.5.2. Authority To Restrict Mandatory Pre-Dispute Arbitration. The Act authorizes the SEC to issue rules prohibiting, or imposing conditions or limitations upon, the use of agreements between brokers, dealers and municipal securities dealers, on the one hand, and their customers or clients, on the other hand, and agreements between investment advisors and their customers or clients, that require future arbitration of disputes under the securities laws or rules. [§921].

9.5.3. Whistleblower Protection. The Act adds new incentives and protections for whistleblowers. [§922] Qualified whistleblowers are entitled to a mandatory monetary reward for voluntarily providing certain information that leads to the successful enforcement of any action brought by the SEC under the securities laws that results in monetary sanctions exceeding $1,000,000. Award amounts will range from at least 10 percent to not more than 30 percent of what is collected as monetary sanctions in the action.

Employers are prohibited from retaliating against employees for any lawful whistle blowing act. Whistleblowers who allege unlawful retaliation may sue in federal court and seek reinstatement, two times the amount of any back pay owed plus interest, reasonable attorneys' fees and costs. Waivers or limitations of whistleblowers' rights through pre-dispute arbitration agreements are not valid or enforceable.

> The SEC is required to issue final regulations implementing the whistleblower provisions of the Act not later than 270 days after the enactment of the Act. [§924]

9.5.4. <u>SEC Granted Ability To Serve Subpoenas Nationwide</u>. The Act allows the SEC to serve a subpoena anywhere in the United States for any action or proceeding brought in federal court under the Securities Act, the Exchange Act, the Investment Company Act, or the Advisers Act. [§929E]

9.5.5. <u>Enhanced and Clarified Authority To Prosecute and Seek Remedies for Violation of the Securities Laws</u>. The Act expands the scope of conduct that may support a claim for aiding and abetting or control person liability under the Exchange Act and provides the SEC with additional authority to pursue remedial relief under the securities laws.

9.5.5.1. <u>Aiding and Abetting Violations of the Securities Laws</u>. The Act allows the SEC to prosecute claims for aiding and abetting violations of the Exchange Act if a person "knowingly or recklessly," not just knowingly, provides substantial assistance to another person. [§929O]

9.5.5.2. Expanded Ability To Seek Remedies under the Securities Act and Investment Company Act. The Act provides the SEC with the authority to seek injunctive relief and civil penalties in federal court against persons who aid and abet violations of the Securities Act and the Investment Company Act. [§929M]

9.5.5.3. Expanded Ability To Seek Remedies under the Advisers Act. The Act authorizes the SEC to seek civil penalties from those charged with aiding and abetting a violation of the Advisers Act. [§929N]

9.5.5.4. Enhanced Ability To Enforce the Securities Laws. The Act provides the SEC with the authority to seek civil penalties in cease and desist proceedings under the Securities Act, the Exchange Act, the Investment Company Act and the Advisers Act. The Act provides federal courts with jurisdiction over actions involving extraterritorial conduct brought by the SEC or the United States under the anti-fraud provisions of the Securities Act, the Exchange Act and the Advisers Act. In addition, the Act expands the scope of who can be held liable as a control person under the Exchange Act to include those who control others whom the SEC, and not just a private individual, sues for violation of the securities laws. [§929P]

9.6. Securities Investor Protection Corporation Reforms. The Act amends the cash protection provisions in Securities Investor Protection Act ("SIPA") to the "maximum cash advance limit," which has been increased to $250,000 and indexed to provide for an inflation review and adjustment every 5 years. Securities Investor Protection Corporation ("SIPC") consent will generally be required before a member with at least one customer may enter into a bankruptcy, insolvency or receivership proceeding. [§929H]

9.7. Short Sale Reforms. The Act amends the Exchange Act to require the SEC to adopt rules mandating that institutional investment managers (Form 13F filers) publicly disclose short sales of securities. The rule mandate does not include disclosure of short sellers; however, the Act amends the Exchange Act to prohibit manipulative short sales and to require broker-dealers to notify their customers that they may opt out of permitting their securities to be used by their broker-dealer in connection with short sales and that their broker-dealers may earn compensation in connection with lending customer securities.[§929X]

9.8. SEC and Other Agencies May Share Information without Waiving Privilege. The SEC will not be deemed to have waived any privilege applicable to any information by transferring that information to, or permitting that information to be used by, another Federal department or agency, the Public Company Accounting Oversight Board ("PCAOB"), an SRO, or a foreign or State securities or law enforcement authority. Similarly, no Federal department or agency, State securities or law enforcement agency, SRO or the PCAOB will be deemed to have waived any privilege by transferring information to the SEC or permitting information to be used by SEC, except that this provision will not apply to an SRO or the PCAOB in regard to information they provide that is used by the SEC in an action against such entities. In addition, the SEC shall not be compelled to disclose information provided to the SEC by any foreign securities or law enforcement authority if such authority has represented in good faith that the information is privileged.[§929K]

9.9. Enhanced Application of Antifraud Provisions. The Act broadens or clarifies the application of the current antifraud provisions of the Securities Exchange Act in several respects relating to the parties and transactions covered by such provisions.[§929L]

9.10. Improvements to the Regulation of Credit Rating Agencies. The Act expands the regulation of credit rating agencies, including nationally recognized statistical ratings organizations ("NRSROs") by the SEC. It also requires NRSROs to maintain more robust internal supervision of the ratings process, imposes increased accountability on credit rating agencies, including NRSROs and attempts to reduce reliance on ratings from credit rating agencies. It also requires NRSROs to comply with a number of additional procedures designed to increase transparency and mitigate conflicts of interest in the credit ratings process with the goal of improving the quality and integrity of the credit ratings provided by NRSROs.

9.10.1. Mitigation of Conflicts of Interest at NRSROs. A number of provisions of the Act are directed at mitigating actual or perceived conflicts of interest that could impair the integrity of credit ratings provided by NRSROs, which include those described below.[§932]

9.10.1.1. Internal Controls. NRSROs must establish an effective internal control structure governing implementation of and adherence to policies, procedures and methodologies for determining credit ratings, taking into account such factors as the SEC may prescribe, and document such internal control procedures. On an annual basis, each NRSRO must submit to the SEC a report, containing an attestation from the NRSRO's Chief Financial Officer, identifying its internal control structure, and describing the role of management.

9.10.1.2. Separation of Marketing Considerations from the Production of Ratings. The SEC is directed to issue rules intended to require NRSROs to manage conflicts of interest by separating their sales and marketing activities from all areas involved in the production of ratings in order to prevent sales and marketing considerations from influencing the production of ratings. Small NRSROs are exempted from these rules if compliance would pose an unreasonable burden on the NRSRO.

9.10.1.3. Employee Look-Back Requirement. If an employee of any issuer, underwriter, sponsor or other entity subject to a credit rating provided by an NRSRO was employed by that NRSRO and participated in any way in determining such credit rating, the NRSRO is required to "look-back" for the one-year time period preceding the date an action was taken with respect to that credit rating to determine whether that employee was influenced by a conflict of interest. If an NRSRO determines such a conflict of interest existed, the NRSRO must revise the rating, if appropriate, in accordance with rules to be issued by the SEC. The SEC is required to conduct a review of each NRSRO's compliance with these policies, as well as its ethics procedures, at least annually and whenever such a policy is materially modified.

9.10.1.4. Report of Certain Employment Transitions. Each NRSRO must report to the SEC if a person who was employed at such NRSRO over the previous five years as a senior officer, an employee who participated in determining credit ratings or a supervisor of an employee who participated in determining credit ratings left its organization to obtain employment with an obligor, issuer, underwriter or sponsor of a security or money market instrument for which the NRSRO issued a credit rating during the twelve-month period prior to the employee's departure.

9.10.1.5. Compliance Officers. Each NRSRO is required to have a compliance officer who is not involved in determining credit ratings, development of ratings methodologies or performing marketing or sales functions. The SEC may exempt small NRSROs from this requirement if compliance would pose an unreasonable burden on the NRSRO. The compensation of an NRSRO's compliance officer may not be tied to the NRSRO's financial performance.

9.10.1.6. Corporate Governance, Organization, and Management of Conflicts of Interest. Each NRSRO must have a Board of Directors with at least one half (but not fewer than two) of the directors being independent in accordance with specified guidelines. One or more of the independent directors must be users of NRSRO ratings. The SEC has the discretion to exempt small NRSROs from this requirement if compliance would pose an unreasonable burden on the NRSRO.

9.10.2. Additional Penalties and Potential Liabilities for NRSROs. The Act contains additional penalties which may be imposed by the SEC and broadens the potential liability of an NRSRO in connection with securities offerings. [§§932, 933 and 934]

9.10.2.1. Additional Penalties. The SEC may suspend or revoke an NRSRO's registration upon a determination that the NRSRO lacks adequate financial or managerial resources to consistently produce credit ratings with integrity. In addition, the SEC is authorized to fine an NRSRO, with consideration given to, among other things, an NRSRO's failure to produce ratings with integrity over time. [§932(a)]

9.10.2.2. SEC Enforcement Actions. The SEC's prohibition against regulating the substance of credit ratings is expressly stated not to be a defense to an anti-fraud action brought by the SEC.

9.10.2.3. Private Right of Action; State of Mind in Private Actions. A private right of action for securities law violations may be brought against a credit rating agency. Enforcement and penalty provisions now apply to statements made by a credit rating agency in the same manner and extent as statements made by registered public accountants or securities law analysts. It is sufficient for the purposes of pleading a required state of mind in a private securities action against a credit rating agency that the complaint set forth facts giving rise to a strong inference that the credit rating agency failed either (i) to conduct a reasonable investigation of the rated security with respect to the factual elements it relied upon in its methodology for evaluating credit risk; or (ii) to obtain reasonable verification of such factual elements from other sources that the NRSRO considered to be competent and that were independent of the issuer and underwriter.[§933]

9.10.2.4. Referring Tips to Law Enforcement or Regulatory Authorities. NRSROs must now report information received from a credible third party alleging that an issuer of securities rated by the NRSRO has committed or is committing a material violation of the law. The NRSRO is not required to verify the accuracy of any such information. [§934]

9.10.3. Oversight of NRSROs; Improvements to Transparency. There are new procedures for SEC oversight of NRSROs, as well as new obligations on NRSROs to make the credit rating process more transparent.

9.10.3.1. Establishment of Office of Credit Ratings. The SEC is required to establish an Office of Credit Ratings, which must have a Director and sufficient staff. The stated purposes of this Office are to protect users of credit ratings, promote accuracy in credit ratings, and ensure that ratings are not influenced by conflicts of interest. The Office is required to audit each NRSRO annually and examine whether each NRSRO adheres to its own standards, manages conflicts of interest, implements ethics policies, and processes complaints. The Office is also required to examine the activities of each NRSRO's compliance officers and its policies governing post-employment opportunities of former staff. The SEC is required to make its inspection reports available to the public.[§932(a)]

9.10.3.2. Transparency of Ratings Performance. The SEC is directed to issue rules requiring NRSROs to publicly disclose information on their initial ratings of each security and any subsequent changes to such ratings. These rules are intended to allow users of credit ratings to evaluate the accuracy of those ratings and to compare the performance of ratings by different NRSROs.

9.10.3.3. Credit Rating Methodologies and Procedures. The SEC is required to issue rules for the protection of investors and the public interest with respect to each NRSRO's procedures and methodologies, including qualitative and quantitative data models used to produce ratings. These rules will require each NRSRO to ensure that its credit rating procedures are in compliance with standards approved by its senior credit officer or board of directors (or similar body). They will also require that, when material changes to rating procedures and methodologies occur, such changes are applied consistently to all ratings to which such changed procedures and methodologies apply. These rules will also require notification to ratings users of the occurrence of either a material change in a policy or procedure or an error.

9.10.3.4. Disclosure of Credit Rating Methodology Assumptions and Third-Party Due Diligence Services. The SEC is to issue rules which will require each NRSRO to disclose assumptions underlying its procedures and methodologies, as well as the data relied upon to determine a rating. To facilitate the disclosure process, the SEC is directed to develop a form, which is intended to be easy and helpful for users of credit ratings, to accompany the disclosure of the credit ratings.

An issuer or underwriter of any asset-backed security is required to make publicly available any third-party due diligence reports it uses. Any NRSRO, issuer or underwriter which employs third-party due diligence services must disclose whether and to what extent third-party due diligence services have been used in the ratings process. Any third parties providing due diligence services to an NRSRO must certify in writing that it has conducted a thorough review of the relevant data and other necessary information.

9.10.3.5. <u>Consideration of Information from Sources Other than the Issuer</u>. In producing a credit rating, each NRSRO is required to consider information the NRSRO has or that it receives from outside sources (other than the underwriter or issuer) that it finds credible and potentially significant to a rating decision. [§935]

9.10.3.6. <u>Universal Rating Symbols</u>. NRSROs will be required to clearly define and disclose the meaning of any symbols used in connection with its credit ratings and to use each such symbol in a consistent manner with respect to all types of securities for which that symbol is used. Each NRSRO may, however, use different sets of symbols to identify ratings for different types of securities.[§938]

9.10.3.7. <u>Qualification Standards for Credit Rating Analysts</u>. The SEC is required to issue rules requiring NRSRO employees to be tested for knowledge of the credit rating process or to otherwise meet standards necessary to produce accurate ratings. [§936]

9.10.4. <u>Reducing Federal Agency Reliance on Credit Agencies</u>. The Act attempts to reduce the reliance of Federal agencies on credit determinations from credit rating agencies. [§§939 and 939A]

9.10.4.1. <u>Removal of Statutory Reference to Credit Ratings</u>. Effective two years after enactment of the Act, various statutory references to credit rating agencies and credit ratings will be removed from numerous federal statutes, including portions of the FDI Act and the Investment Company Act of 1940. Generally, these statutes will now require the responsible governmental agencies to establish alternative standards of determining credit-worthiness, rather than relying on credit rating agencies or their ratings.[§939]

9.10.4.2. <u>Review of Reliance on Ratings</u>. Within one year, each Federal agency is required to review any regulation issued by such agency that either requires the use of an assessment of the credit-worthiness of a security or money-market instrument or references regulations regarding credit ratings. These regulations must then be modified to remove references to or reliance on credit ratings and substitute a standard of credit-worthiness deemed appropriate, taking into account various specified factors.[§939A]

9.10.5. <u>Timing, Additional Studies and Reports</u>.

9.10.5.1. <u>Timing of Regulations</u>. The SEC is required to issue final regulations regarding the regulation of credit rating agencies within one year, except as otherwise set forth in the Act. [§937]

9.10.5.2. <u>SEC Study on Strengthening Credit Rating Agency Independence</u>. The SEC is required to conduct a study of the independence of NRSROs and how this affects credit rating issues. The SEC must evaluate, among other things, management of conflicts of interest raised by NRSROs providing other non-rating services and the potential impact of a prohibition on such services. The SEC must report to Congress the results of this study within three years.[§939C]

9.10.5.3. Comptroller General Study on Alternative Business Models. The Comptroller General is required to conduct a study of alternative means for compensating NRSROs to create incentives to provide more accurate ratings and report the results of this study to Congress within eighteen months. [§939D]

9.10.5.4. Comptroller General Study on the Creation of an Independent Professional Analyst Organization. The Comptroller General is directed to conduct a study on the feasibility and merits of creating an independent professional organization that would establish independent standards and an ethics code for NRSRO ratings analysts, as well as oversee the profession, and report the results of this study to Congress within one year.[§939E]

9.10.5.5. Study and Rulemaking on Assigning NRSROs to Rate Structured Finance Products. The SEC is required to conduct a study on the credit ratings process for structured finance products and the conflicts of interest associated with issuer-pay and subscriber-pay models, ways to measure the accuracy of credit ratings, and alternative ways to compensate NRSROs to create incentives for accurate credit ratings. This study will also evaluate the feasibility of establishing a public or private utility or self-regulating organization that would assign NRSROs to determine the credit ratings on structured finance products, including assessing appropriate methods for determining and paying fees to NRSROs, whether such a system would be viewed as creating a moral hazard issue, whether there are constitutional issues associated with such a system, and means to determine the accuracy of credit ratings. The SEC is required to report the results of this study to Congress within two years. After completion of this study, the SEC will determine whether it is necessary or appropriate to establish a system for assigning NRSROs to determine the initial credit ratings of structured finance products and issue a rule accordingly.[§939F]

9.10.5.6. Standardization Study. The SEC is required to conduct a study regarding the feasibility and desirability of standardizing credit rating terminology across credit rating agencies and across asset classes, standardizing market stress conditions under which ratings are evaluated, and requiring a quantitative correspondence between ratings and a range of default probabilities and loss expectations under standardized stress conditions. The SEC is required to report the results of this study to Congress within one year from the date of enactment of the Act.[§939]

9.11. Improvements to the Asset-Backed Securitization Process. In the context of asset-backed securitization, the Act pursues the general goal of investor protection by emphasizing the importance of collateral quality and focuses on two main objectives: (i) implementing structural changes in the issuance of certain asset-backed securities ("ABS") to require risk retention by securitizers and originators at a default level of up to 5% to promote the credit quality of the assets being securitized; and (ii) requiring additional disclosure relating to the securitized assets to enable investors to independently assess credit quality.[§941] The lending standards established under this provision of the Act are likely to have a significant impact on the characteristics of loans originated by lenders.

> The SEC, the Federal banking agencies (defined as the FDIC, the Fed and OCC), the Secretary of Housing and Urban Development ("HUD Secretary") and the FHFA are required to jointly issue risk retention regulations for securitized residential mortgage assets ("Residential ABS Rules") within 270 days of enactment. These regulations are to become effective 1 year after the publication of the final rules.
>
> With respect to all other classes of securitized assets, the SEC and the Federal banking agencies are required to jointly issue risk retention regulations generally within 270 days of enactment ("General ABS Rules"). These regulations are to become effective 2 years after

The General ABS Rules will establish a number of exemptions from and qualifications to the general 5% risk retention requirement. Most significantly, the Act provides that qualified residential mortgages will be exempt from risk retention obligations pursuant to the Residential ABS Rules, though other exemptions may still apply outside of the qualified residential mortgage category.

9.11.1. General Requirements for Risk Retention. The main component of the Act's approach to ABS is an effort to ensure prudent origination practices by requiring securitizers (defined as an issuer of ABS or a sponsor of an ABS transaction) and originators of assets sold to a securitizer to retain an interest in a portion of the credit risk in any assets transferred, sold, or conveyed by it through the issuance of ABS. The theory behind this approach is that requiring securitizers and originators to keep some "skin in the game" in the form of these retained interests, will gives these parties an increased incentive to maintain high quality underwriting and risk management practices.

The core of this risk retention program will be implemented through the General ABS Rules. Although the SEC and Federal banking agencies are given a great deal of discretion in formulating the risk retention regulations, the regulations must include a number of features, including the following points.

9.11.1.1 Risk Retention Levels. Securitizers will be required to retain an economic interest at a default level of no less than 5% of the credit risk for any securitized asset. As discussed below, this default requirement is subject to certain qualifications. Although qualified residential mortgages will generally be exempt from risk retention, qualified residential mortgages that are securitized in a pool that includes even one residential mortgage that falls outside the definition of "qualified residential mortgage" will nonetheless be subject to risk retention.

The General ABS Rules will specify the permissible forms of risk retention and the minimum required duration of such retention. No risk retention will be required with respect to the securities issued by a finance subsidiary and held by its parent company or an affiliate controlled by such parent if none of the finance subsidiary's securities were held by an unaffiliated entity.

9.11.1.2 Prohibition Against Hedging and Transfer. Securitizers will not be permitted to directly or indirectly hedge or otherwise transfer the credit risk required to be retained by such securitizers.

9.11.1.3 Establishment of Asset Classes. The General ABS Rules will establish various classes of assets as regulators deem appropriate, such as residential mortgages, commercial mortgages, commercial loans, and auto loans. The Federal banking agencies will establish underwriting standards for each of these asset classes that indicate the terms, conditions and characteristics of a loan in each asset class that are consistent with reduced credit risk. These standards will be included in the regulations designating the relevant asset class. If an originator of assets meets the underwriting standards for such asset class set by these rules, then a securitizer of such assets may be subject to a risk retention requirement of less than 5%.

Certain asset classes are singled out for special treatment with respect to risk retention. For instance, the Act designates collateralized debt organizations ("CDOs"), securities collateralized by CDOs, and similar instruments collateralized by other ABS as assets for which the SEC and Federal banking agencies must specifically develop appropriate risk retention standards. The SEC and Federal banking agencies are also required to specify the permissible types, forms, and amounts of risk retention appropriate for commercial mortgage assets. With respect to commercial mortgage assets, these risk retention requirements may involve: (i) retention of either a specified amount or a percentage of the asset's total credit risk; (ii) retention of a first loss position by a third-party purchaser that specifically negotiates the acquisition of such position, holds adequate loss reserves, performs due diligence on all individual assets in the pool and meets the same standards for risk retention that would be required of the securitizer; (iii) a determination with respect to the adequacy of underwriting standards and controls; and (iv) provision of adequate representations, warranties and enforcement rights.

9.11.1.4 Allocation of Risk Retention Between Securitizers and Originators. With respect to any securitizer that purchases assets from an originator, risk retention obligations will be allocated between the securitizer and the originator. Distributing the risk retention obligation among securitizers and originators will not increase the total level of risk retention. The amount of risk otherwise required to be retained by the securitizer will be reduced by the amount of the risk retention allocated to the originator. In determining the appropriate allocation, the SEC and Federal banking agencies will consider whether the assets sold to the securitizer have features suggesting low credit risk, whether the form or volume of transactions in the relevant securitization market encourages imprudent origination practices, and how the distribution of risk retention obligations might affect business and consumer access to credit.

9.11.2 Exemption for Qualified Residential Mortgages; Other Exemptions. The Act's implementing regulations will include a number of mandatory and elective exemptions and exceptions to the risk retention requirement. The specified exemptions, and the exemptions that regulators may adopt going forward, may apply both to asset classes and institutional categories. The most important among these is the exemption applicable to qualified residential mortgages.

9.11.2.1 Exemption for Qualified Residential Mortgages. Subject to some limitations, qualified residential mortgages will be exempt from the general 5% risk retention requirement as established by the Residential ABS Rules. The theory behind the exemption is that mortgages meeting the definition of "qualified residential mortgage" will represent assets of a sufficiently high credit quality to obviate the need for risk retention. To ensure that this is the case, the rulemaking entities will jointly define the term "qualified residential mortgage" to reflect underwriting and product features historically associated with reduced risk of default, including: (i) documentation and verification of mortgagor financial resources; (ii) standards with respect to mortgagor's income relative to housing and other monthly payment obligations; (iii) mitigation of the potential for payment shock on adjustable rate mortgages; (iv) mortgage guarantee insurance or other types of insurance or credit enhancement to the extent it reduces the risk of default; and (iv) limitations on balloon payments, negative amortization, prepayment penalties, interest only payments and other features associated with increased risk of default.

The definition of "qualified residential mortgage" will not be permitted to be broader than the definition of "qualified mortgage" provided in the Truth in Lending Act, as amended by the Consumer Financial Protection Act of 2010 and regulations thereunder.

To qualify for the exemption, an issuer of ABS collateralized solely by qualified residential mortgages will be required to certify that it has effective internal controls for ensuring that all the assets collateralizing such issuance of ABS are qualified residential mortgages. ABS collateralized by tranches of other ABS (whether or not this collateral includes residential mortgage backed securities backed by qualified residential mortgages) will not be eligible for this exemption.

9.11.2.2 Other Categories of Exemptions. Besides the qualified residential mortgage exemption, the Act identifies various types of assets and institutions that will be eligible for total or partial exemptions if the SEC and Federal banking agencies jointly determine that they are in the public interest and appropriate for protection of investors. The implementing regulations will provide for such exemptions for assets issued or guaranteed by: (i) the United States or an agency of the United States (excluding Fannie Mae and Freddie Mac); (ii) any political subdivision of a State or territory; (iii) or any public instrumentality of a State or territory that is exempt from registration under Section 3(a)(2) of the Securities Act and (iv) certain qualified scholarship funding bonds. The SEC and Federal banking agencies are given discretion to determine whether an exemption based on the above authority will be total or partial.

The Act also provides a definitive exemption (an exemption not dependent on subsequent regulation) from its risk retention provisions for any loan or other financial asset made, insured, guaranteed, or purchased by any institution subject to the supervision of the Farm Credit Administration. Definitive exemptions are also given to residential, multi-family, or health care facility mortgage loan assets (or securitizations based on such assets) insured or guaranteed by the United States or an agency thereof (excluding the Fannie Mae, Freddie Mac and the Federal Home Loan Banks).

9.11.2.3 General Exemptions. The SEC and Federal banking agencies may, in the General ABS Rules, provide for total or partial exemption of any securitization from risk retention requirements if such exemption is deemed to be in the public interest and appropriate for the protection of investors. The SEC and the Federal banking agencies also have general authority to jointly adopt exemptions, exceptions, or adjustments to the rules issued in regard to risk retention requirements. Such exemptions, exceptions or adjustments may be made available for categories of institutions or classes of assets and may relate to risk retention requirements or the prohibition against hedging. Any such exemption, exception or adjustment must help ensure high underwriting standards for affected securitizers and originators, encourage appropriate risk management practices, and improve consumer and business access to credit.

> The FRB, in consultation with the OCC, FDIC, OTS and SEC, will study the combined impact on each individual class of ABS of the new risk retention requirement and FAS 166-167. The report, due within 90 days of enactment, will include statutory and regulatory recommendations for eliminating negative impacts on the ABS markets and on the availability of credit for new lending.
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> The Chair of the Oversight Council will study and report on the macroeconomic impact of the risk retention requirements, with a particular focus on the potential benefits to the stability of the real estate market within 180 days of enactment of the Act. [§946]

9.11.3. <u>Required Issuer Due Diligence</u>. In addition to imposing a risk retention feature to encourage higher origination standards, the Act calls for issuers of ABS to conduct an assessment of the quality of the assets underlying such securities. The SEC will issue rules requiring each issuer of ABS to review the assets underlying such ABS and to disclose the nature of this review. [§945]

> The SEC is required, not later than 180 days following the enactment of the Act, to issue rules relating to the registration statements filed by issuers of ABS.

9.11.4. Required Issuer Disclosures. The disclosures regarding an ABS issuer's asset diligence described above will help provide investors with information regarding the quality of assets included in a securitization. Moreover, to meet the objective of enabling investors to independently assess the credit quality of the assets underlying an issuance of ABS, the Act requires disclosure of additional information relating to the assets included in the securitization.

9.11.4.1. Asset-level Information. The centerpiece of this enhanced disclosure is the requirement that each issuer of ABS must disclose, for each tranche or class of security, specific information regarding the underlying assets. The SEC is required to adopt regulations establishing standards for the format and content of such disclosure, though no time frame for their adoption is given. To the extent feasible, the format of disclosure must facilitate comparisons of data across ABS in similar asset classes. To the extent necessary for the investor's independent diligence, the disclosure must include asset-level or loan-level data, including unique identifiers of loan brokers or originators, the type and amount of compensation received by such brokers or originators, and the amount of risk retention by such originator and the securitizer. [§942(b)]

9.11.4.2 Disclosures Accompanying Ratings. In addition to the asset-level information described above, the Act also requires enhanced disclosure with respect to the representations and warranties used in the ABS market. Each NRSRO providing a credit rating with respect to an issuance of ABS will be required to include in its ratings report a description of the representations and warranties made in, and the investors' enforcement rights under, the transaction documents relating to such issuance.

This description must also include an indication of how these representations, warranties, and enforcement rights differ from those found in similar ABS issuances. [§943]

> The SEC is required, not later than 180 days following the enactment of the Act, to issue rules relating to the disclosure to be included in the ratings report provided by an NRSRO in connection with its rating of an issuance of ABS.

9.11.4.3 Repurchase Requests. While asset-level information will assist investors in independently assessing the quality of assets comprising a securitization pool, such assessment does not address the historical performance of the securitizer's or originator's underwriting or risk management practices. To address this, the regulations relating to disclosures accompanying ratings will also require that each sponsor of a securitization must disclose its history of repurchase requests and the fulfillment or non-fulfillment thereof across all ABS issuers aggregated in the securitization platform of such sponsor so that investors may identify originators with clear underwriting deficiencies.[§943]

9.12. Corporate Governance and Executive Compensation. The Act includes a number of provisions intended to enhance shareholder understanding of executive compensation and to increase shareholder involvement in the compensation process. The Act also has provisions that impose substantive requirements in regard to compensation activities. All but one of these provisions apply only to public companies, and, in some instances, are further limited to only listed companies. These measures include:

- "say on pay" provisions whereby companies are required to hold non-binding votes on executive compensation and golden parachutes;

- requiring that members of compensation committees be independent directors;

- disclosure comparing company performance with executive compensation paid and the ratio of the chief executive officer's compensation to that of the median of all other employees of the company;

- a prohibition on the payment by certain financial companies, including banks and BHCs, of incentive compensation that provides excessive compensation or that could lead to material financial loss;

- "clawback" provisions that provide compensation awarded to executives who have engaged in wrongdoing are required to pay back their compensation to the company;

- disclosure regarding whether the roles of CEO and Chairman have been separated;

- restrict proxy voting by brokers on behalf of security holders; and

- authorize the SEC to permit shareholders to nominate nominees for board positions.

9.12.1. Shareholder Vote on Executive Compensation. Not less than once every three years, a proxy, consent or other authorization in connection with an annual or other shareholder meeting for which compensation disclosure is required under the proxy rules shall include a non-binding resolution to approve the compensation of the executives. These requirements supplement existing proxy rules on executive compensation applicable to public companies. The company's shareholders are to determine in a separate vote whether the compensation vote described above should be every 1, 2 or 3 years. This vote on the frequency shall be not less than once every six years. These requirements go into effect six months following enactment. [§951]

9.12.2. Disclosure and Vote on Golden Parachutes. Within six months of enactment of the Act, in every proxy, consent or authorization relating to shareholder approval of merger, acquisitions or similar transactions involving a public company, the person making the solicitation shall disclose any agreements or understandings with any named executive officer for compensation that is based on the transaction, the total of the compensation, and the conditions of paying the compensation. In addition, the proxy, consent or authorization shall provide for a separate non-binding resolution to vote on the golden parachute arrangement.

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| The SEC is directed to adopt regulations to create a form for the golden parachute disclosure. |

9.12.3. Shareholder Votes Are Nonbinding. The Act provides that shareholder votes on executive compensation and golden parachute are non-binding and should not be construed to overrule a decision by the issuer or board of the issuer; they do not create or imply a change in the fiduciary duties (or a new fiduciary duty) of the issuer or board nor do they restrict or limit any shareholder compensation proposals.

9.12.4. Disclosure of Votes by Institutional Investment Managers. Institutional investors that are subject to 13F reporting (generally more than $100 million under management), are required to disclose votes on executive compensation and golden parachute proposals.

9.12.5. Exemptions. The SEC may, by rule, exempt an issuer or class of issuers from the executive compensation and golden parachute proposals. In determining whether to grant an exemption, the SEC is instructed to determine whether the requirements “unduly burden” small issuers.

9.12.6. Compensation Committee Independence.

9.12.6.1. General Independence Requirements. National securities exchanges and national securities associations will be prohibited from listing any equity security that does not conform to the requirement that each member of the issuer's compensation committee be (i) a board member and (ii) independent.[§952]

9.12.6.2. Exclusions. Controlled companies (i.e., 50% voting power held by individual, group or other issuer), limited partnerships, open-end investment companies, companies in bankruptcy, and foreign private issuers that disclose their compensation committee arrangements are excluded from these requirements.

> The SEC is directed to issue regulations within 360 days to direct securities exchanges and national securities association to prohibit listing of any equity security that fails to comply with requirements relating to compensation committees and the related rules regarding independence, disclosure and compensation and these regulations are required to provide an opportunity to cure defects. The SEC is also given the authority to exempt issuers from these provisions, considering the impacts on small issuers.

9.12.6.3. Use of Compensation Consultants, Legal Counsel and Advisors. Compensation Committees may utilize compensation consultants, legal counsel, and advisors only after considering their independence, including other services provided to issuer, fees received from issuer, stock ownership of these individuals and other business and professional relationships between these individuals relating to the issuer. The compensation committee is responsible for the appointment and oversight of any consultant, legal counsel or advisor that it retains. The committee is not required to follow advice of the compensation consultant, legal counsel or advisor and their hiring does not affect the duties of the compensation committee. In any proxy statement filed on or after one year, issuer shall disclose whether compensation committee retained a compensation consultant and whether the work of the consultant raised any conflicts of interests.

The SEC is directed to issue rules that identify factors affecting independence of compensation consultants. The SEC is also directed to issue disclosure rules relating to retention of and the presence of conflicts of any compensation consultant.

9.12.6.4. Study Regarding Compensation Consultants. The SEC is directed to conduct a study on use of compensation consultants and report to Congress within two years.

9.12.7. Disclosure of Pay versus Performance. Public companies will be required to include in their executive compensation disclosure proxy and consent material information that shows the relationship between executive compensation paid and the issuer's financial performance, taking into account stock price changes and distributions. This may include a graphical presentation.[§953]

The SEC shall issue rules to effectuate the pay versus performance disclosure requirements.

9.12.8. Comparing the CEO's compensation to the employees. Issuers will be required to disclose in any federal securities law filings that require compensation disclosure the (i) the median of the annual total compensation of all employees except the CEO; (ii) the annual total compensation of the CEO; and (iii) the ratio of (A) to (B).

The SEC is directed to issue regulations to require these disclosures for those public company filings that require the disclosure of executive compensation.

9.12.9. Disclosure of Hedging Arrangements. Public companies will be required to disclose in their proxy (or consent) solicitations for an annual meeting whether any employee or board member (or a person on their behalf) is permitted to engage in any hedging transaction designed to hedge or offset the value of equity securities granted to the employee or board member as incentive compensation or is otherwise held directly or indirectly by the employee or board member. Hedging transactions include prepaid variable forward contracts, equity swaps, collars and exchange funds designed to implement the hedging described above. Note that this disclosure requirement is triggered upon merely being permitted to engage in hedging.[§955]

> The SEC is directed to issue regulations to require these hedging disclosures in proxy and consent filings.

9.12.10. Clawback or Recoupment of Executive Compensation. If an issuer is required to prepare an accounting restatement due to "material noncompliance of the issuer," the issuer will recover from any current or former executive officer who received incentive-based compensation during the 3 years prior to the date of the restatement, the excess of what would have been paid under the restatement. This requirement will be enforced through the listing requirements of the national securities exchanges and national securities associations which shall prohibit the listing of any issuer that does not comply with these requirements. [§954]

> The SEC is directed to issue regulations to direct the securities exchanges and securities associations to impose these "clawback" requirements.

9.12.11. Incentive Compensation by Financial Institutions that is deemed "excessive" or could be deemed to cause risky behavior.

9.12.11.1. Disclosure and Reporting Requirements. "Covered financial institutions" (see below) will be required to disclose to the appropriate Federal regulator the structures of all incentive-based compensation arrangements that provide an executive officer, employee, director or principal shareholder with excessive compensation, fees or benefits, or that could lead to material financial loss to the Covered Financial Institution. This is not intended to require disclosure of the compensation of individuals. [§956]

9.12.11.2. <u>Substantive Restrictions</u>. Incentive compensation that regulators determine encourages inappropriate risks by either providing excessive compensation or that could lead to a material loss by the covered financial institution will be prohibited.

9.12.11.3. <u>Standards</u>. The compensation requirements must be comparable to those in place under the FDI Act for insured depository institutions

9.12.11.4. <u>What are "Covered Financial Institutions?</u>" These are depository institutions, depository institution holding companies, broker-dealers, credit unions, investment advisers, Fannie Mae, Freddie Mac, and any other financial institution that the regulators determine should be covered. Although applicable to all financial institutions, irrespective of whether they are publicly traded, a covered financial institution must have assets greater than $ 1 billion to be subject to these requirements.

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| These disclosure and substantive requirements will be implemented through regulations jointly issued by the appropriate Federal regulators within nine months of enactment of the Act. |

9.12.12. <u>Restrictions on Voting by Brokers</u>. Voting by brokers for directors, executive compensation matters, and other significant matters as determined by the SEC will be prohibited, unless the shareholder has instructed his or her broker to vote in accordance with voting instructions. These provisions are effective immediately but do not apply to uncontested director elections for registered investment companies.

Securities exchanges are permitted to adopt stricter broker voting restrictions not covered by the above. [§957]

> The SEC may adopt rules to restrict broker voting in other significant matters.

9.12.13. Proxy Access. The SEC has the discretion to require public companies to include shareholder nominees for director. [§971]

> The SEC may adopt rules to permit shareholder access to an issuer's proxy solicitation materials for shareholder nominees to the board. The SEC is permitted to exempt certain issuers or classes of issuers from these requirements and in determining whether to make exemptions, the SEC is directed to consider the burden on small issuers.

9.12.14 Disclosures Regarding Chairman and CEO Structures. Public companies will be required to disclose in annual proxies the reasons why that issuer has chosen either the same or different persons to serve as chief executive officer and chairman of the board of directors. [§972]

> The SEC is directed to issue disclosure rules to effectuate the CEO/chairman disclosure within 180 days from enactment.

9.13. PCAOB Authority. The Act amends the authority of the PCAOB to permit them to establish an inspection program for auditors of broker-dealers and to permit the PCAOB to refer investigations concerning audit reports for broker-dealers to FINRA or other self-regulatory organizations.[§982]

9.14. Portfolio Margining. The Act amends the SIPA to clarify that options on commodities are treated the same as claims for securities with respect to customer claims, and that customers include those who have a claim against a debtor broker-dealer that include options and futures acquired as part of portfolio margining, but exclude those whose claim is part of the capital of the debtor broker-dealer.[§983]

9.15. Securities Lending. The Act amends the Exchange Act to add a subsection prohibiting securities lending activity in contravention of rules prescribed by the SEC. The grant of authority is in addition to any safety and soundness authority the federal banking regulators have over bank securities lending activities. The SEC is directed to promulgate rules not later than 2 years after enactment of the Act.[§984]

9.16. Comptroller General Study of Proprietary Trading. The Act directs the Comptroller General to study the risks and conflicts of proprietary trading and report to Congress 15 months after enactment.[§989]

9.17. Improvements to the Management of the SEC. The Act contains a series of measures intended to evaluate the operations of the SEC and to improve its operations. These measures will, among other things, address internal controls, personnel management and oversight of FINRA.[§961-968]

9.18. Municipal Securities. This Act creates a new registration requirement for persons who fall within the definition of a "municipal advisor"; changes the composition of the Municipal Securities Rulemaking Board ("MSRB"); requires the Comptroller General to conduct studies of municipal disclosure and municipal markets; creates a funding mechanism for the Government Accounting Standards Board ("GASB"); and elevates the office within the SEC that is responsible for oversight of the municipal securities markets.

9.18.1. Registration of Financial Advisors. A new category of registrant will be created by the legislation – "municipal advisor." Firms that seek business from, or provide advice to a municipal entity "with respect to municipal financial products or the issuance of municipal securities" fall within the definition. In addition, a "municipal advisor" includes a financial advisor who is a "guaranteed investment contract broker", "third party marketer", "placement agent", "solicitor", "finder", or "swap advisor". The definition specifically does not include other persons, including registered broker-dealers and investment advisers, already subject to SEC or CFTC registration. Municipal advisors now must register with the SEC and become members of FINRA. They also will be subject to specific new rules of the MSRB.

The legislation creates a fiduciary relationship between a municipal advisor and any municipal entities to whom it provides services, specifying that the municipal advisor may not engage in any act, practice, or course of business which is not consistent with a municipal advisor's fiduciary duty or that is in contravention of the rules of the MSRB.[§975]

9.18.2. Reorganization of the Municipal Securities Rulemaking Board. The new legislation will reconfigure the MSRB to create greater public representation. The newly constituted MSRB Board will be comprised of 15 individuals, with only seven affiliated with the dealer community. The legislation also will expand the authority of the MSRB to regulate municipal advisors, cooperate in enforcement actions with FINRA and the SEC, and permit the Board to charge fees for the submission or retrieval of disclosure and trade information maintained in its databases. In addition there must be at least one representative of issuers, one representative of retail or institutional investors and one municipal securities expert. A separate provision will require FINRA to share with the MSRB one-third of any fines that it collects for violations of MSRB rules. [§975]

9.18.3. Comptroller General Study of Disclosure in the Municipal Markets. The Act mandates that the Comptroller General conduct a study of the municipal securities markets, including the adequacy of disclosure provided to investors; and compare the quality of disclosure in the municipal markets to that in the corporate market. The Comptroller General is required to make recommendations, including specifically whether or not the controversial "Tower Amendment", which prevents the SEC from regulating the issuance of municipal securities, should be repealed. The report must be provided to Congress within 24 months of enactment of the Act.[§976]

9.18.4. Comptroller General Study of the Municipal Securities Markets. Within 18 months after enactment, the Comptroller General must conduct a study of the municipal securities markets, including quality of trade execution, market transparency, trade reporting, price discovery, settlement clearing, and credit enhancements, and make recommendations for improvements. The SEC has 180 days to respond to the study indicating the action the Commission has taken in response to the recommendations of the report. [§977]

9.18.5. Funding for GASB. FINRA will be required to establish fees to support the GASB in establishing standards of financial accounting and reporting for state and local governments. The legislation also mandates a study by the GAO within 180 days of effectiveness, addressing the role and importance of GASB in the municipal markets, and the adequacy of its funding.[§978]

9.18.6. Creation of an Office of Municipal Securities within the SEC. Currently, the SEC has only a small staff located within the SEC's Division of Trading and Markets that is devoted to full time policy oversight of the municipal markets. The legislation would elevate the importance of this function within the SEC by creating a separate Office of Municipal Disclosure whose director would report directly to the Chairman of the SEC.[§979]

9.19. Comptroller General Study of Proprietary Trading. Within 15 months after enactment, the Comptroller General must conduct a study regarding the risks and conflicts associated with proprietary trading, including whether proprietary trading presents a material system risk to the stability of the financial systems and to the safety and soundness of covered entities that engage in such activities. [§989]

9.20. Senior Investor Protection Grants. Provides for the Office of Financial Literacy to provide grants to states and other eligible entities for enhanced protection of seniors from being misled by false designations in the sale of financial products. The Office will be responsible for creating performance objectives and reporting requirements for States and eligible entities who receive a grant through this program.[§989A]

9.21. Changes to and Studies Regarding Section 404(b) of the Sarbanes-Oxley Act. The Act provides that the auditor attestation requirement of Section 404(b) of the Sarbanes-Oxley Act no longer applies to non-accelerated SEC filers (issuers with less than $75 million in market capitalization). The SEC had postponed the effectiveness of Section 404(b) for several years, but without this provision non-accelerated filers would be required to include an auditor's attestation report in their annual report filed for a fiscal year ending on or after June 15, 2010. This will be beneficial to many community banks since it could significantly reduce their costs of being public companies. In addition to the permanent exemption for smaller issuers, the SEC is also directed to report on ways to reduce Section 404(b) compliance costs for companies with public floats between $75 million and $250 million. [§989G]

Within three years of enactment, the Comptroller General is to study the impact of the amendments made by this Act to section 404(b) of Sarbanes-Oxley, including whether issuers that are exempt from 404(b) have fewer or more restatements of published accounting statements than those who are not exempt, how the cost of capital for issuers compares between those who are exempt and those who are not, and whether there is any difference in the confidence of investors in the integrity of financial statements of issuers that are exempt and those who are not. [§989I]

9.22. <u>Custodians of Investment Company and Adviser Client Assets</u>. The SEC has been given authority to require custodians holding registered investment company assets or investment adviser client assets to maintain records relating to custody or use of such assets and to require production of such records. Custodians may include banks – even though they are not subject to SEC jurisdiction. [§929Q]

9.23. <u>SEC Match Funding</u>. The Act changes the manner in which the SEC obtains its annual funding. Currently, the SEC is subject to the standard Congressional appropriations process for the Administration budget, and though the agency collects more in fees than Congress appropriates, the excess fees become general funds of the Treasury, to which the SEC has no claim. Under the new system, the SEC would submit its budget directly to Congress and would be allowed to use some of the fees it collects to establish a $100 million reserve fund, on which it could draw without Congressional approval but subject to Congressional reporting.

Starting with the 2012 fiscal year budget process, the Act will make the following changes to the SEC's funding. (i) <u>Direct submission to Congress of itemized budget</u>: The SEC will submit an itemized budget to Congress and the President. The budget will include itemized funds for carrying out the SEC's functions and amounts to be designated as contingency funding, and it will name activities for which multi-year budget authority would be suitable. [§991(d)] (ii) <u>Establishment of reserve fund</u>: Registration fees collected by the SEC will be deposited into a reserve fund, subject to a $50 million limit for any single fiscal year, and a $100 million aggregate limit on the balance at any time. Amounts in excess of these limits are deposited as general funds in the Treasury and are not available to the SEC. [§991(e)] (iii) Use of reserve fund and reporting: The SEC may use up to $100 million from the reserve fund in any one fiscal year. Within 10 days after the SEC obligates amounts in the fund, the SEC must notify Congress of the date, amount, and purpose of the obligation. (iv) Target registration fee amounts: The SEC will set its registration fees to achieve a target registration fee collection amount. The Act sets target registration fee collection amounts for fiscal years 2012 through 2020, with amounts starting at $425 million in 2012 and increasing each year to $705 million in 2020 (the current statutory amount is $394 million for 2011). [§991(b)] (v) Matching budget to transaction fees: The SEC is authorized to set transaction fees (paid by the exchanges and national securities associations based on transaction volume) at an amount designed to cover Congress's annual appropriation to the SEC. [§991(a)] (vi) Authorization of additional appropriations: The Act sets out specific appropriation authorization amounts for the SEC through fiscal year 2015, which are in addition to any other funds appropriated. These amounts start at $1.3 billion for 2011 and increase to $2.25 billion for 2015. [§991(c)]

9.23.1. What Entities are Impacted and How? The impact will primarily be on the SEC itself, which will have additional resources and more control over its budget. The changes are also likely to impact SEC registrants, securities firms that are members of the exchanges and FINRA, and other entities subject to SEC jurisdiction. SEC registrants and member firms may be affected by higher fees from increased target fee collection rates. Other entities subject to SEC jurisdiction may be affected to the extent increased resources lead to increased SEC activity – such as filing review, rulemaking, inspections of regulated entities, and enforcement.

9.24. Exemption for State-Regulated Equity-Indexed Annuities. Section 989J of the Act (also known as the Harkin Amendment) is targeted at removing equity indexed annuities from SEC jurisdiction. This provision will require the SEC to treat certain state-regulated annuities as exempt securities under the Securities Act of 1933, and therefore not subject to SEC registration requirements or required to be sold by SEC-registered broker dealers.

Specifically, the provision creates an exemption under the federal securities laws for any insurance or endowment policy or annuity or optional annuity contract (a contract) that meets the following requirements: (i) the value of the contract does not vary according to the performance of a separate account (thus variable annuities cannot claim the exemption); (ii) the contract satisfies applicable standard nonforfeiture laws at the time of issue (if applicable State law does not have such a provision, the nonforfeiture requirements of the Model Standard Nonforfeiture Law published by the National Association of Insurance Commissioners ("NAIC") would govern); and (iii) sales of the contract must be subject to suitability standards established by the NAIC and state monitoring of compliance with those standards. [§989J(a)]

The suitability standards requirement can be met: (i) for contracts issued on or after June 16, 2013, if the contract is issued in a State or by an insurance company domiciled in a State that has adopted either the NAIC's model regulation for Suitability in Annuity Transactions or suitability requirements that substantially meet or exceed the minimum requirements established by the NAIC model regulations; or (ii) for contracts issued at any time, if the issuing insurance company has adopted and implemented practices on a nationwide basis that meet or exceed the NAIC standards and sales are subject to state monitoring for compliance.

This provision is a direct response to the SEC's 2009 adoption of Rule 151A, which would have required SEC registration of equity indexed annuity contracts as securities and the sale of these products by registered broker dealers in accordance with SEC and FINRA sales practice standards. Rule 151A, which had a delayed effective date and never became effective, was challenged in court and remanded to the SEC on procedural grounds, leaving substantial uncertainty as to the status of these contracts under the federal securities laws. The new exemption eliminates that uncertainty with respect to equity indexed contracts and other contracts that meet the requirements established by the provision, but it does not affect the exempt status of any other insurance, endowment, or annuity policy. [§989J(b)]

9.24.1. <u>What Entities are Impacted and How</u>? This provision directly affects issuers of equity indexed annuities and the insurance agents that sell them, by removing these contracts and related sales practices from federal regulation. It also indirectly affects issuers of fixed and variable life insurance in general, as it changes the competitive landscape by reducing regulatory burdens relating to a particular product. The exemption may also have an impact on issuers of other insurance products that are currently registered as securities, such as certain market value adjusted fixed annuities, to the extent those contracts meet the requirements of the exemption. The reduction in regulatory burdens for affected issuers could be substantial, as registering a product may trigger periodic reporting and other obligations under the Exchange Act and the Sarbanes Oxley Act of 2002. Finally, the new exemption may also put pressure on states and insurance companies to adopt suitability standards applicable to the sale of annuities and life insurance products.

enforcement is shared with several prudential regulators. The Bureau has primary supervisory and enforcement authority over certain nondepository institutions (principally those in the mortgage business and large providers of consumer financial services) and depository institutions with more than $10 billion in assets and their affiliates.

The Bureau's new powers over consumer financial activities include activity to: prohibit practices that it finds to be unfair, deceptive or abusive; in addition to the broad rule-making authority under various consumer statutes, to mandate particular disclosures; and to prohibit or restrict pre-dispute arbitration practices.

Depending on the approach taken by the Bureau, Title X has the potential to have a very significant impact on what consumer financial services will be available in the U.S. and the manner in which they will be provided.

Title X increases the potential for State intervention in the operations of Federally chartered depository institutions by narrowing the circumstances in which preemption of State law may apply and by providing statutory recognition of a role for state law enforcement authorities in regard to Federally chartered depository institutions.

The Bureau has responsibility for mortgage reform and enforcement as set forth in Title XIV, the "Mortgage Reform and Anti-Predatory Lending Act."

Finally, Title X includes a provision that limits interchange fees for debit card transactions to an amount that is deemed to be reasonable under regulations issued by the Fed.

10.1. Establishment of the Bureau. The Bureau has a rather unique structure. It is established within the Federal Reserve System but will be treated as an independent bureau. It will have the status of an executive agency.[§1011]

10.1.1. How will the Bureau be Organized. The Director of the Bureau ("Director") will be appointed to a five-year term by the President and must be confirmed by the Senate. The Director can only be removed by the President for cause. The Director is the Bureau's only political appointment with the Deputy Director being appointed by the Director and empowered to conduct the affairs of the Bureau in the absence of the Director.[§ 1011] The Director will appear before Congress for hearings on a semi-annual basis to report on the activities of the Bureau and the state of consumer financial protection.[§ 1016] The Director is a member of the Oversight Council, the Board of Directors of the FDIC, and the Federal Financial Institutions Examination Council.[§§111; 332; 1091].

The units within the Bureau will include: (i) a Research Department that will analyze and report on consumer related issues; (ii) a Community Affairs Department that will address the provision of consumer financial products to underserved consumers and communities, and will collect, monitor, and respond to consumer complaints; (iii) an Office of Fair Lending and Equal Opportunity that will provide oversight and enforcement of Federal fair lending laws, including the Equal Credit Opportunity Act ("ECOA") and the Home Mortgage Disclosure Act ("HMDA"), coordinate fair lending efforts of the Bureau with other Federal agencies and with state regulators, and work with financial institutions and consumer groups on the promotion of fair lending compliance; (iv) an Office of Financial Education that will be responsible for developing and implementing consumer education initiatives: (v) an Office of Service Member Affairs that will develop and implement initiatives for members of the military and their family members; and (vi) an Office of Financial Protection for Older Americans, that will develop and implement initiatives for senior citizens.[§1013]

There will also be a Consumer Advisory Board ("Consumer Board") that will consult with the Bureau on Federal consumer financial laws. The Consumer Board will also provide information on emerging practices in the consumer financial products industry. At least six members will be appointed to the Consumer Board by the Director upon the recommendation of the regional Federal Reserve Bank Presidents. The Consumer Board will meet at least twice per year.[§1014]

10.1.2. Transfer of Duties of Financial Regulatory Agencies; Bureau Transfer Date. All consumer financial protection functions of the Fed, the OCC, the OTS, the FDIC, and the National Credit Union Administration ("NCUA") ("Designated Laws") are transferred to the Bureau.[§1061]

A single calendar date for the transfer of functions to the Bureau will be designated by the Treasury Secretary within 60 days of the enactment of the Act ("Bureau Transfer Date"). The Bureau Transfer Date will be not earlier than 180 days nor later than 12 months after the date of enactment of the Act, but may under certain circumstances be extended to no later than 18 months after the date of enactment of the Act.[§1062]

The Treasury Secretary is authorized to perform the functions of the Bureau until the Director is confirmed by the Senate. The Treasury may provide administrative services necessary to support the Bureau before the Bureau Transfer Date.[§1066]

10.1.2.1. Designated Laws. The Designated Laws include (i) the Alternative Mortgage Transactions Parity Act of 1982; (ii) the Consumer Leasing Act of 1976; (iii) the Electronic Fund Transfer Act ("EFTA"); (iv) the ECOA; (v) the Fair Credit Billing Act; (vi) the Fair Credit Reporting Act ("FCRA"), subject to certain exclusions; (vii) the Home Owners Protection Act; (viii) the Fair Debt Collection Practices Act: (ix) certain privacy provisions of the Gramm-Leach-Bliley Act; (x) HMDA; (xi) the Home Ownership and Equity Protection Act of 1994; (xii) the Real Estate Settlement Procedures Act ("RESPA"); (xiii) the S.A.F.E. Mortgage Licensing Act of 2008 ("SAFE Act"); and (xiv) the Truth in Lending Act. [§1002]

10.1.3. Transfer of Functions of the FTC. The authority of the Federal Trade Commission ("FTC") to issue guidelines, conduct a study, or issue a report mandated under Designated Laws will be transferred to the Bureau. The authority of the FTC under the Federal Trade Commission Act ("FTC Act") or any law that is not a Designated Law to prescribe rules, issue official guidelines, or conduct a study or report under any such law will not be affected. The FTC will have authority under the FTC Act to enforce a rule issued by the Bureau with respect to a Covered Person subject to the jurisdiction of the FTC as a violation of a rule issued by the FTC under the FTC Act.[§1061]

10.1.4. Transfer of Functions of the HUD. All of the consumer protection functions of the Department of Housing and Urban Development ("HUD") related to RESPA, the SAFE Act and the Interstate Land Sales Full Disclosure Act are transferred to the Bureau.[§1061]

10.1.5. General Principles Regarding Transfers. The validity of any existing right, duty or obligation of the transferring agency or any person that arises under any provision of law relating to any consumer protection function of the transferring agency will not be affected. Suits by or against a transferring agency relating to consumer protection will not be affected, except that the Bureau (other than in the case of the FTC) will generally be substituted for the transferring agency as a party to the proceeding.[§1063]

The Act provides that no later than the Bureau Transfer Date, the Bureau will publish a list in the Federal Register of rules and orders of transferring agencies that will be enforced by the Bureau. Any proposed rule of a transferring agency regarding consumer protection functions that were proposed before the transfer date but were not published as a final rule shall be deemed to be a proposed rule of the Bureau. Any interim or final rule of a transferring agency regarding consumer protection functions that has not become effective as of the transfer date shall become effective as a rule of the Bureau in accordance with its terms.

10.1.6. Independence. The Act seeks to ensure that while the Bureau will exist within the Fed, it will be autonomous. The Fed may not intervene in a proceeding before the Bureau, take action with regard to Bureau personnel, or merge or consolidate the Bureau. Rules and orders of the Bureau are not subject to approval or review by the Fed. No other Federal government authority will have any authority to require the Bureau to submit an advance version of a communication with Congress, provided the Bureau indicates that the views expressed are those of the Bureau and do not necessarily reflect the views of the President or the Fed. Moreover, neither the Bureau nor the Fed shall be liable under any provision of law for the other party's action or inaction.[§1012]

10.1.7. Funding. The Bureau will be funded by transfers from the combined earnings of the Federal Reserve System beginning with an amount equal to 10 percent of the total operating expenses of the Federal Reserve System for fiscal year 2010 and increasing to 12 percent for fiscal year 2012 and thereafter. The funds received from the Federal Reserve System are not subject to Congressional review. Under certain circumstances, the Director may seek the appropriation of additional funds from Congress.[§1017]

10.2. What are the Duties of the Bureau. The primary functions of the Bureau are: (i) supervising certain Covered Persons (any person that engages in offering or providing a consumer financial product or service, and any affiliate thereof, if the affiliate acts as a service provider to the person) for compliance with Federal consumer financial laws, and taking appropriate enforcement action to address violations; (ii) issuing rules, orders, and guidance implementing Federal consumer financial laws; (iii) conducting financial education programs; (iv) collecting, investigating, and reporting consumer complaints; and (v) collecting, researching, monitoring, and publishing information relevant to the functioning of markets for consumer financial products to identify risks to consumers and the proper functioning of such markets. [§1021]

10.2.1. Consumer Financial Product or Service. The term "consumer financial product or service" means certain financial products or services that are offered for use by consumers primarily for personal, family, or household purposes. These products and services include: (i) extending credit and servicing loans; (ii) providing real estate settlement services; (iii) engaging in deposit-taking activities, transmitting or exchanging funds, or otherwise acting as a custodian of funds or any financial instrument for use by or on behalf of a customer; (iv) selling or providing stored value or payment instruments, subject to certain exceptions; (v) providing payments or other financial data processing products or services, subject to certain exceptions; (vi) providing investment advisory services; (vii) providing consumer reports; (viii) collecting consumer debt; and (ix) other products or services as may be defined by the Bureau by regulation, if the Bureau finds that the product or service (a) is done with the purpose to evade any Federal consumer financial law, or (b) is permissible for a bank or

BHC to offer to or provide under Federal law or a regulation that has, or is likely to have, a material impact on consumers.[§1002]

10.3. Rulemaking Authority. The Bureau will have authority to issue rules, and issue orders and guidance necessary or appropriate to carry out the purposes of Federal consumer financial laws. When conducting any rulemaking under the Federal consumer financial laws, including the Designated Laws, the Bureau shall consider the potential benefits and costs to consumers and Covered Persons, including the potential reduction of access to products or services resulting from the rule, and the impact on Covered Persons.[§1022]

The Bureau has been expressly granted the *Chevron* standard of deference with respect to its determination of the meaning or interpretation of any Federal consumer financial law, and amendments to several of the enumerated laws transferred to the Bureau – EFTA, ECOA, and FCRA – mirror this deferential standard of review.[§1022]

10.3.1. Consultation with Other Regulators. The Bureau is required to consult with the appropriate Federal prudential regulators and other Federal agencies prior to proposing a rule, and during the comment period, regarding the consistency of the rule with prudential, market, or systemic objectives administered by those agencies. The Bureau will be required to publish a description of any objection it receives in the preamble to its final rule, along with the basis for its decision on the objection.

10.3.2. Exemptions. The Bureau may conditionally or unconditionally exempt any class of (i) Covered Persons, (ii) service providers, or (iii) consumer products or services, from any provision of Title X or from any rule issued under the Title. An exemption will be made in consideration of the total assets of the class of Covered Persons, the volume of transactions involving consumer financial products in which the class of Covered Persons engages, and the extent to which consumers are protected by existing provisions of law. If both the Bureau and another Federal agency have been authorized by a Federal consumer law to issue regulations, the Bureau will have exclusive authority to issue rules under those provisions of law, except to the extent that the FTC is granted continuing authority under the Act.[§1022]

10.3.3. Oversight Council Review of Regulations. In another effort to address concerns regarding the operation of the Bureau, the Act contains an unusual provision that gives the Oversight Council the authority to make a Bureau regulation unenforceable. This process is triggered if a member of the Oversight Council that has objected to a proposed rule of the Bureau files a timely petition with the Council to stay the effectiveness or set aside a final rule of the Bureau. A decision to stay or set aside a final rule of the Bureau must be made by the vote of two-thirds of the members of the Council. In order to set aside a rule or a provision of the rule, the Oversight Council must determine that the rule or the provision would put the safety and soundness of the U.S. banking system or the stability of the financial system of the U.S. at risk. A decision of the Oversight Council to set aside a rule will be subject to review under the Administrative Procedure Act. The Oversight Council is required to issue procedural rules regarding the operation of the regulation review process.[§1023]

10.4. Studies and Reports. The Act requires the Bureau to conduct a variety of studies and reports. The Bureau must present annual reports to Congress on the complaints that it received and their resolution, on its efforts to fulfill its fair lending mandate, and on its financial literacy activities.[§1013] The Bureau is required to monitor risks to consumers and is required publish at least one report a year of its significant findings related to such monitoring. The Bureau is required to publish an assessment of the effectiveness of each significant rule or order that it has issued within five years of the effective date of the rule or order, providing for public comment prior to publishing the assessment.[§1022]

The Bureau is required to conduct a study on reverse mortgage transactions within 1 year of the Bureau Transfer Date. If the Bureau determines through its study that conditions or limitations on such transactions are necessary or appropriate to protect borrowers, the Bureau may issue regulations to address such concerns. The regulations may identify any practice as unfair, deceptive, or abusive in connection with a reverse mortgage transaction. The regulations may provide for an integrated disclosure standard, and model disclosures for reverse mortgage transactions, that combine the relevant disclosures required under the Truth in Lending Act and RESPA, with the disclosures required to be provided to consumers for Home Equity Conversion Mortgages under the National Housing Act.[§1076]

The Bureau will conduct a study on the nature, range, and size of variations between the credit scores sold to creditors and those sold to consumers by consumer reporting agencies that compile and maintain files on consumers on a nationwide basis. The Bureau will submit a report to Congress on the results of the study within 1 year of the enactment date.[§1078]

The Bureau will review all Federal laws and regulations relating to the protection of consumers who use like kind property exchange facilitators for transactions primarily for personal, family, or household use. The Bureau will submit a report to Congress, within 1 year of the Bureau Transfer Date, describing recommendations for legislation and for updating regulations to protect such consumers.[§1079]

10.5. Collection of Information. In connection with the Bureau's assessment and monitoring activities, the Bureau is authorized to collect information regarding the organization, business conduct, markets and activities of Covered Persons. The Bureau may obtain such information through a variety of means including surveys of consumers, interviews with Covered Persons, and required filings by Covered Persons and service providers. These information collection activities are subject to provisions intended to address privacy concerns.[§1022]

10.6. Sharing of Examination Reports. Subject to providing reasonable assurances of confidentiality, the Bureau will have access to any examination report or other supervisory information belonging to a prudential regulator or other Federal agency with jurisdiction over a Covered Person or service provider. Similarly, the Bureau, upon reasonable assurances of confidentiality, is to make the same types of information available to a prudential regulator or other Federal agency with jurisdiction over a Covered Person or service provider.

10.7. Registration Requirements. The Bureau is authorized to issue rules regarding registration requirements applicable to Covered Persons, other than insured depository institutions or credit unions and their related persons. Subject to rules issued by the Bureau, the Bureau may publicly disclose registration information in order to facilitate the ability of consumers to identify Covered Persons that are registered with the Bureau.

10.8. Supervision of Covered Persons. Although the Bureau has the authority to issue rules and orders under Federal consumer protection laws governing all Covered Persons, it has much more limited authority in regard to the supervision of Covered Persons. The Bureau may only supervise a specified group of nondepository Covered Persons. It is also limited to supervising only large depository institution Covered Persons.

10.9. Supervised Nondepository Entities. The Bureau has the authority to supervise three categories of nondepository entities. ("Supervised Nondepositories").[§1024]

10.9.1. Participants in Mortgage Lending. The Bureau will have supervisory authority over any nondepository that offers or provides origination, brokerage, or servicing of loans secured by real estate for use by consumers primarily for personal, family, or household purposes.

10.9.2. Larger Participants in Markets for Other Consumer Financial Products or Services. The Bureau will have supervisory authority over larger participants in markets for other consumer financial products, as defined by rule.

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| The Bureau will consult with the FTC prior to issuing a rule to define larger participants in markets for other consumer financial products. The Bureau will issue its initial rule within 1 year of the Bureau Transfer Date. |

10.9.3. Designated Nondepositories. The Bureau will have supervisory authority over any nondepository Covered Person, by order, if it determines the entity is engaging in conduct that poses risks to consumers with regard to the offering of consumer financial products. The Bureau must give notice and an opportunity to respond to the affected entity prior to issuing an order. This determination may be based on complaints or information from other sources.

10.9.4. Private Education Lenders. The Bureau will have authority over any nondepository that offers or provides to a consumer any private education loan, as defined in the Truth in Lending Act.

10.9.5. Payday Lenders. The Bureau will have authority over any nondepository that offers or provides payday loans to consumers.

10.9.6. Service Providers to Covered Entities. Service providers to Supervised Nondepositories will be subject to the authority of the Bureau to the same extent that service providers to banks are subject to the authority of the appropriate Federal banking agency.

10.10. Supervision of Supervised Nondepositories. The Bureau will require reports from, and conduct examinations on a periodic basis of, a Supervised Nondepository to (i) assess its compliance with Federal consumer financial law; (ii) obtain information about the activities and compliance systems or procedures of the entity; and (iii) detect and assess risks to consumers and to markets for consumer financial products and services. Supervision will be risked-based and will take into consideration the asset size of the Covered Person, the volume of transactions involving consumer financial products in which the Covered Person engages, the risks to consumers created by the provision of such consumer financial products, the extent to which such institutions are subject to State oversight, and any other relevant factors.

Bureau supervision will be coordinated with the prudential regulator and State banking regulator supervision. The Bureau will use public information, reports provided by other Federal agencies, and reports provided by State regulators to supplement its own reports and examinations. The Bureau may require Covered Persons to generate, provide, or retain records for the purposes of facilitating supervision and assessing and detecting risks to consumers. The Bureau may require background checks for principals, officers, directors, or key personnel, and bonding or other appropriate financial requirements.

The Bureau generally has exclusive authority to conduct examinations and enforce Federal consumer financial law in regard to a Supervised Nondepository, subject to an agreement with the FTC for coordinating enforcement actions. Any Federal agency otherwise authorized to enforce a Federal consumer financial law may recommend that the Bureau initiate an enforcement action.

> As a general matter, the Bureau will have exclusive authority to issue and enforce regulations with regard to a Supervised Nondepository.

10.11. <u>Limitations on Coverage of Nonfinancial Companies and Other Exclusions</u>. The Act specifies certain types of activities and entities that are not subject to rulemaking, supervisory, enforcement or other authority of the Bureau.[§1027]

10.11.1. <u>Sellers of Nonfinancial Goods.</u> The Bureau will have no authority over sellers of nonfinancial goods, except to the extent that they are offering consumer financial products or are otherwise subject to a Designated Law. In general, the Bureau will have no authority over entities that provide credit directly to consumers exclusively for the purpose of purchasing a nonfinancial good or service from that entity, or for collection or sale of the debt. However, the Bureau will have authority over credit transactions involving the sale of non-delinquent debt and transactions, if the credit extended significantly exceeds the market value of the nonfinancial good or service, or in cases where a seller of nonfinancial goods or services regularly extends credit subject to a finance charge. The Bureau also generally will not have authority over a merchant, retailer or seller of nonfinancial goods or services that is not engaged significantly in offering or providing consumer financial products or services. Certain entities that qualify as a small business will be exempt from otherwise applicable Bureau jurisdiction over the entity.

10.11.2. <u>Real Estate Brokers</u>. The Bureau will have no authority over licensed real estate brokers or real estate agents to the extent they: (i) act as a real estate agent or broker for a buyer, seller, lessor, or lessee of real property; (ii) bring together parties interested in the sale, purchase, lease, rental, or exchange of real property; or (iii) negotiate any portion of a contract relating to the sale, purchase, lease, rental, or exchange of real property (other than in connection with the provision of financing).

10.11.3. Other Exempted Activities. The Act also includes certain exclusions from the Bureau's authority for: (i) manufactured and modular home retailers under certain circumstances; (ii) accountants and tax preparers, subject to certain exceptions; (iii) the practice of law; (iv) an entity regulated by a State insurance regulator, subject to certain exceptions; (v) offerors of employee benefit and compensation plans; (vi) any entity regulated by a State securities commission to the extent that it is engaging in such regulated capacity, subject to certain exceptions; (vii) activities relating to charitable contributions; and (viii) activities regulated by the SEC, the CFTC, or the Farm Credit Administration.[§1027] Motor vehicle dealers that are predominately engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both, generally are not subject to the jurisdiction of the Bureau. The Bureau will have jurisdiction, however, if such a dealer: (i) provides consumers with any services related to residential or commercial mortgages or self-financing transactions involving real property; (ii) extends credit or leases involving motor vehicles directly to consumers and does not routinely assign the governing contract to an unaffiliated third-party; or (iii) offers a consumer financial product or service unrelated to a motor vehicle.[§1029]

10.11.4. No Federal Usury Limit. The Bureau does not have the authority to establish a usury limit applicable to an extension of credit offered or made by a Covered Person to a consumer, unless explicitly authorized by another law. [§1027(o)]

10.12. Supervision of Depository Institutions. The Bureau has full supervisory authority over FDIC-insured depository institutions or insured credit unions with assets over $10 billion ("Supervised Large Depositories") and their affiliates. The Bureau will have more limited supervisory authority in regard to FDIC-insured depository institutions or insured credit unions with assets less than $10 billion ("Small Depositories").

10.13. Supervision of Supervised Large Depositories. The Bureau will have exclusive authority to require reports and conduct examinations of a Supervised Large Depository in order to: (i) assess compliance with the requirements of Federal consumer financial laws; (ii) obtain information about the activities subject to such laws and the associated compliance systems or procedures; and (iii) detect and assess risks to consumers and to markets for consumer financial products.

To the extent that the Bureau and another Federal agency are authorized to enforce a Federal consumer law with respect to a Supervised Large Depository, the Bureau will have primary authority to enforce that law. A Federal agency may recommend in writing to the Bureau that the Bureau initiate an enforcement proceeding in regard to a Supervised Large Depository. If the Bureau does not initiate such a proceeding within 120 days of receiving such a recommendation, the referring agency has backup authority to initiate enforcement proceedings. Service providers to Supervised Large Depositories will be subject to the authority of the Bureau to the same extent as if the Bureau were an appropriate Federal banking agency under the Bank Service Company Act.[§1025]

10.13.1. Coordination with Other Regulators. The Bureau is directed to coordinate with existing regulators (both Federal and State) and will use existing reports to the fullest extent possible. The Bureau will have primary authority over Supervised Large Depositories to enforce Federal consumer financial law. The Bureau will coordinate the scheduling of examinations of Supervised Large Depositories with the supervisory activities of the prudential regulator, conducting simultaneous examinations unless the institution requests the examinations be conducted separately. Draft reports will be shared between the agencies. Examinations will be coordinated with State bank supervisors in the same manner.

If supervisory determinations of the Bureau and the prudential regulator are conflicting, a Supervised Large Depository may request that the agencies coordinate and present a joint statement of coordinated supervisory action. A joint statement is to be provided within 30 days of the request. If the joint statement is not made or an agency takes action without the consent of the other agency, a Supervised Large Depository may appeal to a governing panel, composed of a representative of the Bureau, a representative of the other agency, and a representative of another agency not involved in the dispute. The governing panel will, by majority vote, provide a final determination within 30 days of the appeal being made and all requested information being provided, unless a longer period is agreed to by all involved parties. The information contained in the determination will be published. The Bureau and other agencies will provide safeguards from retaliation against the Supervised Large Depository. These requirements do not apply to decisions to appoint a conservator, receiver, or liquidating agent or a decision to take action under the Prompt Corrective Action provisions of the FDI Act.

10.14. <u>Limited Bureau Supervision of Small Depositories</u>. The Bureau is authorized to include its examiners on a sampling basis on examinations conducted by prudential regulators of Small Depositories. In such instances, the prudential regulator is to provide all information related to the exam process to the Bureau; involve the Bureau representative in the entire exam process; and consider input from the Bureau regarding all aspects of the examination.

The applicable prudential regulator will have exclusive authority (relative to the Bureau) to enforce the requirements of Federal consumer financial laws for Small Depositories. If the Bureau believes a Small Depository is engaged in a material violation of Federal consumer financial law, the Bureau will recommend the prudential regulator take appropriate action. The prudential regulator will reply to the Bureau within 60 days of receipt of such notice.

In connection with its responsibilities in regard to Small Depositories, the Bureau may require reports from Small Depositories.[§1026]

10.15. Prohibition against Unfair, Deceptive or Abusive Acts or Practices. The Bureau may take action to prevent a Covered Person or a service provider from committing or engaging in an unfair, deceptive, or abusive act or practice under Federal law in connection with a consumer financial product.

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| The Bureau may issues rules identifying as unlawful, unfair, deceptive, or abusive acts or practices in connection with a consumer financial product. These rules may include requirements for the purpose of preventing such acts or practices. |

The Bureau will issue these rules in consultation with other Federal agencies.[§1031]

10.15.1. Criteria. The Bureau may not declare a practice unfair unless the practice is likely to cause substantial injury to consumers not reasonably avoidable by consumers, and the injury to consumers is not outweighed by countervailing benefits to consumers or to competition. The Bureau is directed to consider established public policies, but such policy considerations may not serve as a primary basis for its determination.

The Bureau may not declare a practice abusive unless the practice materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product, or takes unreasonable advantage of: (i) a lack of understanding by a consumer of the material risks, costs, or conditions of the product; (ii) the inability of the consumer to protect their interests in selecting or using a consumer financial product; or (iii) the reasonable reliance by the consumer on a Covered Person to act in the interests of the consumer. In issuing rules regarding unfair, deceptive or abusive practices, the Bureau shall provide that creditors may consider the seasonality and irregularity of the documented income of a borrower in the underwriting of, and scheduling of payments for, an extension of credit secured by residential real estate.[§1031]

10.16. Model Disclosures. The Bureau may issue rules to ensure that the features of a consumer financial product are fully, accurately, and effectively disclosed to consumers in a manner that permits consumers to understand the costs, benefits, and risks associated with the product or service. Any rule requiring disclosures may include a model form that may be used at the option of the Covered Person for provision of the required disclosures. The model form will contain a clear and conspicuous disclosure that will use plain language comprehensible to consumers, contain a clear format and design, and succinctly explain the information that must be communicated to the user. Any Covered Person that uses a model form will be in compliance with the Bureau's disclosure requirements. The model form is to be validated through consumer testing. In issuing disclosure rules, the Bureau is to consider evidence about consumer awareness of, understanding of, and responses to disclosures about consumer financial products.

The Bureau may permit a Covered Person to conduct a trial program for the purposes of providing trial disclosures to consumers. A safe harbor will be available to any Covered Person that participates in an authorized trial.

> Not later than 1 year after the Bureau Transfer Date, the Bureau will propose for public comment rules and model disclosures that combine the disclosures required under the Truth in Lending Act and RESPA, into a single, integrated disclosure for mortgage loan transactions covered by those laws.[§1032]

10.17. Consumer Access to Information. Covered Persons will be required to make available to a consumer, upon request, information concerning the consumer financial product or service that the consumer obtained from the Covered Person, including information relating to any transaction, series of transactions, or to the account including costs, charges, and usage data, subject to the rules issued by the Bureau. This information is to be made available in an electronic form usable by consumers. There are certain limitations on this requirement. Covered Persons are not required to make available: (i) confidential commercial information; (ii) information collected for the purpose of preventing fraud, money laundering, or other unlawful conduct; (iii) information required to be kept confidential by any other provision of law; or (iv) information that the Covered Person cannot retrieve in the ordinary course of business.

This provision does not impose a duty on a Covered Person to maintain or keep any information about a consumer. The Bureau will consult with other Federal agencies to ensure, to the extent appropriate, that the rules: (i) impose substantively similar requirements on Covered Persons; (ii) take into account conditions under which Covered Persons do business in the U.S. and abroad; and (iii) do not require or promote the use of any particular technology.

> The Bureau will create standards to promote the development and use of standardized formats for information, including through the use of machine readable files, to be made available to consumers.[§1033]

10.18. Response to Consumer Complaints and Inquiries. The Bureau will establish procedures, in consultation with other Federal regulatory agencies, to provide a timely response to consumer complaints or inquiries. The procedures shall include addressing: (i) steps that have been taken by the regulator in response to the complaint or inquiry; (ii) responses received by the regulator from the Covered Person; and (iii) follow-up actions or planned follow-up actions planned by the regulator to respond to the complaint. A Supervised Large Depository is required to provide a timely response to the Bureau, the prudential regulators, and any other agency with jurisdiction over the Covered Person regarding the actions it has taken in response to the consumer complaint. As with requests by a consumer for information from a Covered Person, there are similar limitations on the information that the Bureau or a prudential regulator or other Federal regulator may be required to provide to the consumer. The Bureau is directed to enter into a memorandum of understanding with any affected Federal regulatory agency in regard to compliance with this provision.[§1034]

10.19. Authority to Restrict Mandatory Pre-Dispute Arbitration. The Bureau is required to conduct a study concerning the use of agreements providing for arbitration of any future dispute between Covered Persons and consumers in connection with the offering or providing of consumer financial products or services.[§1028] The Bureau is to report to Congress on its findings.

The Bureau may, by regulation, prohibit or impose conditions or limitations on the use of an agreement that provides for mandatory pre-dispute arbitration. This provision does not prevent a consumer from entering into a voluntary agreement with a Covered Person after a dispute has arisen.

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| Any regulation issued by the Bureau regarding mandatory pre-dispute arbitration shall apply to any agreement between a consumer and a Covered Person entered into after the end of the 180-day period beginning on the effective date of the regulation. |

10.20. Prohibited Acts. The Act makes it unlawful for any Covered Person or service provider (i) to offer or provide to any consumer any financial product or service that is not in conformity with Federal consumer law, or otherwise commit any act or omission in violation of a Federal consumer financial law; or (ii) to engage in any unfair, deceptive, or abusive act or practice. It is also unlawful for any Covered Person or service provider to fail or refuse, as required by Federal consumer financial law, or any rule or order issued by the Bureau, to permit access to records, to establish or maintain records, or to make reports or provide information to the Bureau. Finally, it is unlawful for any person to knowingly or recklessly provide substantial assistance to a Covered Person or service provider in violation of the provision prohibiting unfair, deceptive or abusive acts or practices, or any rule or order issued thereunder. The provider of such substantial assistance shall be deemed to be in violation of that provision to the same extent as the person to whom such assistance is provided.[§1036]

10.21. Preemption of State Law and State Enforcement.

10.21.1 Greater State Law Protection Is Not in Conflict with the Act. The substantive consumer protection provisions in Title X, and the regulations issued by the Bureau do not prevent State laws and regulations that afford "greater protection" to consumers, as determined by the Bureau. However, such State laws may continue to be preempted by the National Bank Act or the HOLA if they violate the applicable preemption standards. Finally, if a majority of the States enact a resolution in support of a consumer protection standard, the Bureau is to issue a notice of proposed rulemaking to implement that standard.[§1041]

10.21.2. State Civil Enforcement of Federal Laws Through Courts. A State Attorney General (or similar State official) may bring an action in Federal District Court or State court to enforce the consumer protection provisions of Title X including regulations issued by the Bureau. In such a proceeding, the Attorney General may secure remedies authorized by Title X or authorized by any other provision of Federal or State law. With respect to national banks and Federal savings associations, a State Attorney General may bring an action to enforce the Bureau's regulations, but not the underlying statute. A State Attorney General may also bring an action to enforce any other applicable State or Federal law against a national bank or Federal savings association.[§§1042(a); 1047]

A State regulator (other than an Attorney General) may also enforce Title X and the Bureau's regulations against a State-chartered, incorporated or licensed entity, or against any entity that is authorized to do business under State law.[§1042(a)]

10.21.3. Preservation of Existing Contracts. Title X and the Bureau's regulations will not be construed to alter or affect the applicability of any OCC or OTS regulation, order or interpretation regarding the applicability of State law to any contract entered into on or before the date of enactment by a national bank, Federal thrift, or subsidiaries thereof. [§1043]

10.21.4. Preemption Standard for National Banks and Federal Savings Associations. Title X provides that a State consumer protection law is preempted if: (i) application of the law would have a discriminatory effect on national banks or Federal savings association; (ii) the law is preempted by a provision of Federal law other than the National Bank Act; or (iii) in accordance with *Barnett Bank v. Nelson,* the State law "prevents or significantly interferes" with the exercise of a national bank of its powers. If asked to make a preemption determination, the OCC must act on a "case by case" basis, meaning that the OCC determination must relate to a particular State law, but can also relate to the laws of another State with substantively equivalent terms (after consulting with the Bureau). The same standards also apply with respect to Federal savings associations. The Comptroller may not delegate to another the authority to issue a preemption determination.[§§1044; 1046]

10.21.5. Judicial Review. A preemption determination by the OCC is subject to judicial review. However, rather than giving the agency "*Chevron*" deference, the court is directed to assess the validity of the preemption determination, depending upon the thoroughness evident in the agency's consideration, the reasoning of the agency, the consistency of the decision with other determinations, and other factors the court may find persuasive. Further, the court may not uphold a determination to preempt a State law unless it finds that the determination is supported by substantial evidence, made on the record of the proceeding. [§1044]

10.21.6. Usury and Interest. The new preemption provisions do not affect the current authority of national banks to establish and export interest rate ceilings. [§1044(f)]

10.21.7. Subsidiaries, Affiliates and Agents. State consumer financial laws apply to national bank subsidiaries, affiliates and agents.[§§1044(e); 1045]

10.22. Investigations and Enforcement Actions by the Bureau. The Bureau is authorized to conduct investigations and to take enforcement actions to enforce Title X and Federal consumer law.

10.22.1. Investigations. The Bureau is authorized to conduct investigations to determine whether any person is, or has been, engaged in a violation of Federal consumer financial law. Such investigations may be conducted jointly with other regulators, and in the case of fair lending matters, may be conducted with HUD or the Department of Justice. Investigations may include subpoenas for testimony or documents.[§1052]

10.22.2. Enforcement Proceedings. The Bureau may institute administrative enforcement proceedings. The Act specifies the requirements applicable in connection with cease and desist proceedings. The Bureau is authorized to seek a cease and desist order against a Covered Person or service provider that is subject to the jurisdiction of the Bureau, if the Bureau believes that such party is engaged in, or has engaged in, any activity that violates a law, rule, or any condition imposed in writing by the Board. The Board may issue a temporary cease and desist authority if it believes that the continuance of such activity during the pendency of the cease and desist proceedings would cause the party to be insolvent or otherwise prejudice the interests of consumers. The Act provides for an administrative process and judicial review similar to that available under the enforcement provisions of Section 8 of the FDI Act.[§1053]

10.22.3. Civil Litigation Authority. The Bureau may bring a civil action in an appropriate U.S. District Court against a person subject to its jurisdiction for the imposition of a civil penalty or other legal or equitable relief, including a temporary or permanent injunction. The Bureau is directed to coordinate such legal actions with the Department of Justice.[§1054]

10.22.4. Remedies. The court in a civil action, or the Bureau in an administrative proceeding, may grant any appropriate legal or equitable relief in regard to a violation of Federal consumer law, including a rule issued thereunder. This relief may include: (i) rescission or reformation of contracts; (ii) refunding money or returning real property; (iii) restitution; (iv) disgorgement or compensation for unjust enrichment; (v) payment of damages or other monetary relief; (vi) public notification regarding the violation; (vii) limits on the activities or functions of the person; and (viii) civil monetary penalties. The Act does not, however, authorize punitive damages.

> The Bureau, a State attorney general, or any State regulator may recover costs of litigation to enforce any Federal consumer financial law, if it is the prevailing party.

The relief granted by a court or in an administrative proceeding may include civil money penalties. The Act establishes three tiers of civil money penalties ranging from $5,000 per day to $1,000,000 per day. The Act also establishes mitigating factors to be considered in the assessment of such penalties.[§1055]

10.22.4.1. Consumer Financial Civil Penalty Fund. All civil penalties collected in an administrative proceeding or in a civil action will be deposited into the Consumer Financial Civil Penalty Fund. The Bureau will use the funds for payments to victims of activities for which civil penalties have been imposed under the Federal consumer financial laws. If it is not practicable to make payments to victims, the funds may be used for the purpose of consumer education and financial literacy programs.[§1017]

10.22.5. Criminal Referrals. If the Bureau obtains evidence of conduct that may constitute a violation of Federal criminal law, it is required to transmit the evidence to the Attorney General.[§1056]

10.23. Whistleblower Protection. The Act provides that a Covered Person or service provider may not terminate or in any other way discriminate against, an employee who has taken specified steps to provide information in regard to a violation of Federal consumer financial law. Whistleblower protection also extends to an employee that has objected to or refused to participate in an activity that he or she reasonably believed to be in violation of any law, rule, order, standard or prohibition subject to the jurisdiction of, or enforceable by, the Bureau. The Act provides procedures for an employee for bring a claim before the Secretary of Labor. If the Secretary determines a violation occurred, the Secretary will order the person who committed the violation (i) to take affirmative action to abate the violation, (ii) to reinstate the employee and pay back pay, and (iii) to provide compensatory damages to the complainant. The Secretary will assess costs and expenses incurred by the complainant. The Secretary may award attorney costs of up to $1,000 to the prevailing employer in the case of a frivolous claim.

These rights and remedies cannot be waived in an employment contract. No pre-dispute arbitration agreement will be valid or enforceable to the extent it requires arbitration of a dispute arising under these whistleblower protections.[§1057]

10.24. Fee Restrictions and Rules for Payment Card Transactions.

10.24.1. Rules Regarding Interchange Fees for Electronic Debit Transactions.

> The EFTA is amended to authorize the Fed to issue regulations regarding any interchange transaction fee that an issuer may receive or charge for an electronic debit transaction (a transaction in which a person uses a debit card). The amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction must be reasonable and proportional to the cost incurred by the issuer with respect to the transaction. Regulations to establish standards to assess whether a charge is reasonable and proportional are to be issued in final form within 9 months of the date of enactment of the Act.
>
> Network fees are distinguished from interchange transaction fees, and are defined as those fees received by a network related to a debit transaction that are not interchange transaction fees. The Fed has authority to issue rules on network fees, limited to ensuring that network fees are not used to compensate issuers for debit transactions or to otherwise circumvent interchange fee regulations.
>
> The Fed will retain jurisdiction for drafting interchange fee regulations although authority for drafting rules under the EFTA is transferred to Bureau. Additionally, the civil and criminal penalties of EFTA would not apply to interchange fee regulations.

The Fed may require any issuer or payment card network to provide information necessary to carry out the above provisions. The Fed, after issuing the rules referenced above and then at least twice a year, will disclose the aggregate or summary information concerning the costs incurred, and interchange transaction fees charged or received, by issuers or payment card networks in connection with the authorization, clearance, or settlement of electronic debit transactions as it considers appropriate and in the public interest.

In issuing regulations, the Fed will consider the functional similarities between electronic debit transactions and checking transactions. It is to distinguish between the incremental cost incurred by an issuer specific to a particular electronic debit transaction and other costs incurred by the issuer which are not specific to a particular electronic debit transaction. Costs not specific to a particular electronic debit transaction will not be considered in the assessment of whether a charge is reasonable and proportional.

The Fed may allow for an adjustment to the fee charged if the adjustment is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to electronic debit transactions.

The Fed will establish fraud-related standards. The standards will be designed to ensure that any fraud-related adjustment is limited to the amount reasonably necessary to make allowance for the cost incurred by the issuer in preventing fraud in relation to electronic debit transactions. The standards will ensure any fraud-related adjustment takes into account any fraud-related reimbursements. The standards will require issuers to take effective steps to reduce the occurrence of, and costs from, fraud, including through the development of cost-effective fraud prevention technology. These regulations will be issued in final form within 9 months of the enactment date. The Fed is to consider:

- The nature, type, and occurrence of fraud in debit card transactions;
- The extent to which the occurrence of fraud depends on whether the transaction is based on signature, PIN, or other means;
- The available and economical means by which fraud on debit card transactions may be reduced;
- Fraud prevention and security costs;
- The costs of fraudulent transactions absorbed by each party involved in the transactions;
- The extent to which interchange transaction fees have reduced or increased incentives for parties involved in debit card transactions to reduce fraud; and
- Other factors it considers appropriate.

This provisions will not apply to: (i) any issuer that, together with its affiliates, has assets of less than $10 billion; (ii) an interchange transaction fee charged with respect to a transaction in which a person uses a government-administered program payment card; or (iii) an interchange transaction fee charged with respect to a debit card transaction in which a person uses a general purpose pre-paid card, unless, beginning after the first year of the effective date, the person is charged an overdraft fee or a fee for the first withdrawal per month from an ATM that is part of the issuer's ATM network. Beginning 12 months after the enactment date, the Fed is to annually provide a report to Congress on the prevalence of the use of general pre-paid cards in government-administered payment programs and the interchange transaction fees and cardholder fees charged for the use of such cards.

10.24.2. Limitation on Payment Card Network Restrictions.

> The Fed is to issue regulations, within 1 year of the enactment of the Act, providing that an issuer or payment card network may not restrict the number of payment card networks on which a debit card transaction may be processed to a single network or two or more networks owned, controlled, or otherwise operated by affiliated persons or networks affiliated with the issuer.
>
> The Fed is to issue regulations, within 1 year of the enactment of the Act, providing that an issuer or payment card network may not inhibit the ability of any person who accepts debit cards for payments to direct the routing of debit card payments for processing over any payment card network that may process such transactions.

A payment card network may not: (i) inhibit the ability of any person to provide a discount or in-kind incentive for payment by the use of cash, checks, debit cards, or credit cards; (ii) penalize any person for the providing of a discount that is in compliance with Federal law and applicable State law; (iii) inhibit the ability of any person to set a minimum dollar value for the acceptance of credit cards, so long as the minimum does not exceed $10; or (iv) inhibit the ability of any Federal agency or institution of higher education to set a maximum dollar value for the acceptance of credit cards.

None of these provisions authorize any person to discriminate as to payment networks or card issuers.[§1075]

10.25. Small Business Loan Data Collection. The Act includes a data collection provision for small business lending that is intended to facilitate enforcement of the fair lending laws and to enable interested constituents to identify business and community development needs of women-owned, minority-owned, and small businesses. The Act provides that in the case of any application to a financial institution for credit by a women-owned, minority-owned, or small business, the financial institution must inquire whether the business is such a business. The financial institution must maintain a separate record of the responses to such inquiries.

An applicant for credit may refuse to provide the requested information. Where feasible, the employees involved in making any determination concerning an application for credit shall have access to the information requested. If those employees do have access, the financial institution must notify the applicant of such access and inform the applicant that the institution may not discriminate on the basis of that information.

A financial institution will be required to compile certain information regarding applications by women-owned, minority-owned, and small businesses. This information is to disclose with respect to each application: (i) the number of the application and the date on which the application was received; (ii) the type and purpose of the credit applied for; (iii) the amount of the credit applied for, and the amount of the credit approved; (iv) the type of action taken on the application, and the date of that action; (v) the census tract in which the principal place of business of the loan applicant is located; (vi) the gross annual revenue of the business in the last fiscal year of the business loan applicant preceding the date of the application; (vii) the race, sex, and ethnicity of the principal owners of the business; and (viii) any additional information that the Bureau determines would aid in fulfilling the purposes of this section. The information compiled shall not include any personally identifiable information.

As with HMDA data, this data is to be submitted annually to the Bureau. The Bureau may delete or modify data for purposes of release to the public if such action would advance a privacy interest. It will be made available to any member of the public, upon request, in a form determined by the Bureau. It will also annually be made available to the public generally by the Bureau, in the form and manner set by the Bureau. The Bureau may make exceptions to any requirement of this section and may exempt any financial institution from these requirements.[§1071]

10.26. Remittance Transfers. The Act requires the Fed to issue rules regarding disclosures that must be made by remittance transfer providers, including certain disclosures specified in the Act. The Act also contains provisions regarding the form of such disclosures and error resolution requirements. Each of the Federal banking agencies and the NCUA are to provide guidelines to financial institutions under the jurisdiction of the agency regarding the offering of low-cost remittance transfers and no-cost or low-cost basic consumer accounts, as well as agency services to transfer providers.[§1073]

10.27. Student Loan Ombudsman. The Treasury Secretary will designate a Private Education Loan Ombudsman within the Bureau, to provide assistance to borrowers of private education loans. Information about the availability and functions of the Ombudsman will be spread to borrowers and participants in student loan programs. The Ombudsman will handle complaints from student loan borrowers and will coordinate with the student loan ombudsman under the Department of Education.[§1035]

10.28. Report on Private Education Loans and Lenders. Within 2 years of enactment, the Director and the Secretary of Education, in consultation with the FTC, and the Attorney General are to submit a report to the House and Senate Banking and Education committees on private education loans and lenders and make any regulatory or statutory recommendations to improve consumer protections for private education borrowers.

10.29. Public Disclosure of Use of Credit Scores. A financial institution must provide to the consumer a written or electronic disclosure of a numerical credit score used in taking any adverse action based in whole or in part on any information in a consumer report.[§1100F]

10.30. Treasury Study of Fannie Mae and Freddie Mac Conservatorships and National Housing Finance Policy. The Treasury Secretary will conduct a study of and develop recommendations regarding the options for ending the conservatorship of Fannie Mae and Freddie Mac, while minimizing the cost to taxpayers. Options may include their gradual wind-down and liquidation, their privatization, the incorporation of their functions into a Federal agency, their dissolution into smaller companies, or any other measures the Treasury Secretary deems appropriate.[§1074]

**Title XI**


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11. Title XI – Federal Reserve System Revisions. Title XI narrows the circumstances in which the Fed may provide emergency assistance. It also explicitly authorizes the FDIC to guarantee debts of banks and holding companies.

11.1. Emergency Lending Authority to Be Used Only to Provide Broad-based Liquidity. The Act limits the Fed's emergency lending authority to a program or facility with broad-based eligibility. Such authority may be exercised solely for the purpose of providing liquidity to the financial system and not to assist a failing financial company. Loans must be adequately secured to protect taxpayers from losses, and any emergency lending program must be terminated in a timely and orderly fashion. In a notable restriction on the independence of the Fed, the Act provides that the Fed may not establish such an emergency lending program without the prior approval of the Treasury Secretary.[§1101]

11.1.1. Prohibited Borrowers and Programs. Any emergency lending program or facility must prohibit participation by insolvent borrowers. A program or facility that is structured to remove assets from a single, specific company's balance sheet or to assist a single, specific company to avoid bankruptcy, receivership under Title II, or any other insolvency proceeding will not be considered to be a program or facility with broad-based eligibility.

11.1.2. Report to Congress: The Fed is to report to the House and Senate banking committees within seven days of providing emergency assistance and provide updates every 30 days thereafter.

11.1.3. Fed Claims in Event of an Outstanding Loan Recipient Being Placed in Receivership. The Fed's claim against any entity that defaults on a loan from the Fed and that is placed in receivership under Title II will have priority in the liquidation process.

11.2. Comptroller General to Audit Fed Emergency Lending. The Comptroller General may conduct audits of a credit facility offered by the Fed (or Reserve Bank). It is to report to Congress within 90 days of completing such an audit, subject to certain limitations governing the disclosure of sensitive information. Non-redacted copies of the report are to be released within 1 year after the Fed's credit facility terminates.[§1102]

11.3. Public Access to Information Regarding the Fed. The Fed is to create an "Audit" page on its website that contains GAO reports, annual financial reports, reports to Congress, and other information the Fed deems necessary or helpful in understanding the Fed's accounting, financial reporting, or internal controls. It also must release to the public information regarding emergency lending programs and certain lending transactions within one year after the termination of the credit program or on the last day of the eighth calendar quarter following the calendar quarter in which a covered lending transaction occurred.[§1103]

11.4. FDIC Guarantee Program. Upon certain triggering events, the FDIC is to establish a widely available program to guarantee obligations of solvent insured depository institutions or solvent depository institution holding companies and their affiliates during times of severe economic distress ("Guarantee Program"). Any such program may not include the provision of equity in any form.

11.4.1. Process. The Treasury Secretary may ask the Fed and FDIC to determine whether a "liquidity event" (which means (A) an exceptional and broad reduction in the general ability of financial market participants (i) to sell financial assets without an unusual and significant discount; or (ii) to borrow using financial assets as collateral without an unusual and significant increase in margin; or (B) an unusual and significant reduction in the ability of financial market participants to obtain unsecured credit) exists that warrants the use of a guarantee program. If two-thirds of the both the Fed Governors and FDIC directors approve and the Treasury Secretary approves, the FDIC is to create a "widely available" program to guarantee the obligations of solvent banks and holding companies. The terms and conditions are to be set by the FDIC, with the concurrence of the Treasury, and the Treasury (in consultation with the President) is to determine the maximum amount of debt that may be guaranteed. The President then is to seek Congressional approval of the amount. Absent such approval, the FDIC may not guarantee debt.[§1104]

> The FDIC, in consultation with the Treasury Secretary, is required to issue regulations that establish policies and procedures governing the issuance of guarantees. Such policies may include a requirement for collateral as a condition of a guarantee.

11.4.2. Guarantee Program Funding. The FDIC is required to charges fees and other assessments to participants in the Guarantee Program in amounts necessary to cover the costs of the program, including projected losses. To the extent that these fees are insufficient, the FDIC is authorized to impose a special assessment on participants in the program. The

FDIC is authorized to borrow from the Treasury in connection with the program and may not borrow from the Deposit Insurance Fund.[§1105]

11.4.3. Treatment of Borrowers in Default Under Guarantee Program. If an insured depository institution participating in the Guarantee Program or another specified FDIC debt guarantee program defaults on any obligation guaranteed by the FDIC, the FDIC is required to appoint itself as receiver. If a participating company defaults that is not an insured depository institution, the FDIC is to consider whether (i) the company should be placed in receivership under Title II, or to file a petition for bankruptcy under Chapter 11 if the FDIC is not appointed as receiver within 30 days of default or (ii) to file an involuntary petition for bankruptcy on behalf of the company.[§1106]

11.5 Election of Reserve Bank Presidents. Banks no longer will be permitted to vote on who serves as a Reserve Bank president. Instead, only "Class B" and "Class C" directors of a Federal Reserve Bank (i.e., directors that represent the public and that are chosen by the member banks and Fed respectively) will elect the Reserve Bank presidents.[§1107]

11.6. President to Appoint Fed Vice Chairman for Supervision. The Fed will have 2 Vice Chairman under the new law, one of whom is to be designated Vice Chairman for Supervision. The Vice Chairman for Supervision will oversee the supervision and regulation of all entities within the Fed's jurisdiction and is to appear before the House and Senate banking committees at least semiannually.[§1108]

11.7. GAO Audits of the Fed; Fed Disclosure Regarding Assistance. Within 30 days after enactment, the GAO is to commence a one-time audit of all assistance provided by the Fed under its 13(3) powers from Dec. 1, 2007 up to the date of enactment. The audit is to be completed, and a report filed with Congress, within 12 months of enactment. Within one year of enactment, the GAO is to complete an audit of the governance of the Federal Reserve Bank system and report to Congress within 90 days thereafter.[§1109]

**Title XII**

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12. Title XII – Improving Access to Mainstream Financial Institutions. Title XII is intended to improve the access of low- and moderate-income individuals to mainstream financial products. It seeks to accomplish this objective through three programs, none of which are mandatory for financial institutions.

12.1. Treasury to Promote Access to Accounts. The Treasury Secretary is authorized to establish a program of incentives (that may include grants, and various contracts or agreements) intended to enable low- and moderate-income individuals to establish accounts in an insured depository institution that are appropriate to meet their needs. Accounts include deposits accounts, an account for a closed-end loan and other products or services. Parties that may participate in the program include insured depository institutions, and 501(c)(3) organizations ("Eligible Entities"). Eligible Entities may offer services related to such accounts, including, small-dollar loans, and financial education.[§1204]

12.2. Alternatives to Payday Loans. Title XII seeks to provide a low-cost alternative to payday loans for low- and moderate-income individuals. It authorizes the Treasury to establish a program of incentives (that may include grants, and various contracts or agreements) to encourage Eligible Entities to provide low-cost, small dollar value loans. Eligible Entities that participate in this program will be required to provide financial education opportunities to each consumer that receives a loan under such a program.[§1205]

12.3. Grants to Establish Loan-Loss Reserve Funds. The Act authorizes the Community Development Financial Institutions Fund ("Fund") to provide assistance to institutions that qualify as community development financial institutions ("CDFI") to establish and maintain small dollar loan programs. These programs would involve loans of $2,500 or less that must be repaid in installments and that do not have any pre-payment penalty. The Fund is to make grants to CDFIs or to any partnership between a CDFI and a qualifying insured depository institution to establish loan-loss reserve funds to defray the costs of operating small dollar loan programs. Any participating CDFI or partnership of institutions must provide matching funds of at least 50% of the amount received from the Fund. Any funds received from the Fund may not be used to make direct loans to consumers.[§1206]

12.4. Issuance of Regulations. The Treasury Secretary is authorized to issue regulations to implement the provisions of Title XII.[§1209]

**Title XIII**

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13. Title XIII – Pay It Back Act. Title XIII reduces TARP appropriations and mandates several measures for the Treasury to increase its General Fund and reduce the deficit. There are no new obligations imposed on the banking industry as a result of Title XIII.

13.1. Authorized TARP Appropriations. Title XIII decreases the TARP funds authorized under the Emergency Economic Stabilization Act of 2008 ("EESA") from $700 billion to $475 billion. Title XIII provides that for purposes of calculating the amount of authority exercised by the Treasury Secretary to purchase troubled assets under EESA, such amount will not be reduced by: (i) any amounts received by the Treasury Secretary before, on, or after the date of enactment of the Act from repayment of the principal of financial assistance by an entity that has received financial assistance under the TARP or any other program enacted by the Treasury Secretary under EESA; (ii) any amounts committed for any guarantees pursuant to the TARP that became or become uncommitted; or (iii) any losses realized by the Treasury Secretary. Title XIII further provides that no authority under EESA may be used to incur any obligation for a program or initiative that was not initiated prior to June 25, 2010.[§1302]

13.2. Proceeds from Sale of Fannie Mae or Freddie Mac Obligations to be Deposited into Treasury's General Fund. Amounts received by the Treasury Secretary (i) from sale of obligations and securities of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks; and (ii) from certain fees paid by Fannie Mae and Freddie Mac shall be placed in the Treasury's General Fund dedicated for the sole purpose of deficit reduction and may not be used as an offset for other spending increases or revenue reductions.[§1304]

13.3. FHFA Report on the Housing Industry. The Director of the FHFA is required to submit a report to Congress on the Agency's plan to support and maintain the Nation's housing industry while guaranteeing that the taxpayer not face undue losses. This report will presumably address issues related to the future of Fannie Mae and Freddie Mac, which is also to be addressed by a Treasury study required by section 1074 of the Act.[§1305]

13.4. Stimulus Funds Not Accepted or Obligated by States to be Deposited in Treasury's General Fund. If funds provided to a state under American Recovery and Reinvestment Act ("ARRA") are not accepted by the Governor or by the State legislature, the funds will be rescinded and placed in the General Fund of the Treasury. Once in the General Fund, they will be used for the sole purpose of deficit reduction and may not be used as an offset for other spending increases or revenue reductions. Further, Title XIII provides that if the head of an executive agency withdraws or recaptures any ARRA funds not obligated by a State to a local government or for a specific purpose, then those funds shall be rescinded and deposited in the General Fund of the Treasury for the sole purpose of deficit reduction and may not be used as an offset for other spending increases or revenue reductions. Similarly, Title XIII provides that any discretionary ARRA appropriations that have not been obligated as of December 31, 2012 shall be rescinded and such amounts shall be deposited in the General Fund of the Treasury for the sole purpose of deficit reduction and may not be used as an offset for other spending increases or revenue reductions. The President may waive the preceding provision if he determines that it is not in the best interest of the Nation to rescind a specific unobligated amount.[§1306]

**Title XIV**


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## 14. Title XIV – Mortgage Reform and Anti-Predatory Lending Act

In response to widespread concern about a breakdown in the mortgage lending market that some have argued involved (i) lending practices that produced loans that had inadequate assurance of being repaid, thereby adversely impacting the ultimate holders of such loans and (ii) the placement of borrowers in loans that they did not adequately understand or were not financially prepared to repay, Title XIV seeks to prevent practices that may have led to these problems from occurring again.

The provisions of Title XIV will bring significant changes to the mortgage industry. These will include new specific duties on the part of mortgage originators to act in the best interests of consumers and to take steps to seek to ensure that consumers will have the capability to repay loans that they obtain. Title XIV will create incentives for lenders to offer loans that Congress and the regulators believe better protect the interests of consumers, and provide additional protection for borrowers under high cost loans. Title XIV includes significant new disclosure requirements and appraisal reforms. It also includes a series of consumer education initiatives.

14.1. Bureau Authority; Issuance of Regulations. Title XIV provides that most of its provisions will be treated as Designated Laws for purposes of the jurisdiction of the Bureau. Title XIV provides that regulations required under the Title are to be issued in final form before the end of the 18-month period beginning on the Bureau Transfer Date.

14.2. Residential Mortgage Loan Origination Standards. The Act amends The Truth in Lending Act ("TILA") in an effort to ensure that consumers are offered and receive residential mortgage loans that reflect their ability to repay, that are understandable, and that are not unfair, deceptive, or abusive.[§1402(a)]

14.2.1. Qualification and Licensing Standard for Mortgage Originators. Mortgage originators are placed under a duty to be qualified, and, to the extent required under state or Federal law, including the SAFE Act, to be licensed or registered as mortgage originators.

> The Fed must issue regulations requiring depository institutions to establish and maintain procedures for compliance with the licensing and registration requirements for mortgage originators and the SAFE Act.

14.2.1.1. Definition of "Mortgage Originators". Mortgage originators include any person that takes a residential loan application, assists a consumer in obtaining or applying for a mortgage loan, preparing loan packages, or collects information on behalf of the consumer with regard to a loan or offers or negotiates terms of a residential mortgage loan, for direct or indirect compensation. The term does not include persons who perform administrative or clerical tasks relating to the application for a mortgage. It does not apply to loan servicers who work with borrowers on potential loan modifications.[§1401]

14.2.2. Prohibition on Steering Incentives. Direct and indirect compensation to the originator from all sources may not vary with the terms of the mortgage loan, other than the amount of the principal.[§1403] This prohibition does not, however, prevent an originator from receiving compensation from a person other than the borrower if the consumer does not make an upfront payment of points or fees (although this provision may be waived by the Fed if it determines that the waiver is in the interest of consumers and the public interest).

14.2.3. Prohibitions against Certain Mortgage Origination-Related Practices. The Act contains provisions intended to address concerns that have arisen in connection with the 2008-2009 financial crisis that mortgage originators engaged in a range of practices that resulted in borrowers being placed in residential mortgages that it is unlikely they would be able to repay. The Act directs the Fed to issue regulations prohibiting originators from:

- steering a consumer to a residential mortgage that the consumer lacks a reasonable ability to repay (in accordance with regulations under TILA) ;
- has predatory characteristics or effects (such as equity stripping, excessive fees, or abusive terms;
- is not a "qualified mortgage" (as described below) when the consumer qualifies for a qualified mortgage; or
- involves abusive practices that promote credit disparities among consumers of equal creditworthiness but different race, ethnicity, gender or age.

Mortgage lenders will be prohibited from mischaracterizing (i) the credit history of a consumer or the loans available to a consumer; (ii) the loans available to a consumer; or (iii) the appraised value of the security property. They will also be prohibited from discouraging a consumer in certain circumstances from seeking a loan from another mortgage originator.[§1403]

14.2.4. Liability. Mortgage originators who fail to comply with the requirements imposed on them under TILA will be subject to liability not exceed the greater of actual damages or three times the total amount of compensation the originator received from the mortgage loan involved in the violation, plus the cost of the action, including reasonable attorney's fees.[§ 1404]

14.2.5. Discretionary Regulatory Authority. The Fed is directed to issue regulations prohibiting or placing conditions on any terms or practices it finds to be abusive, unfair, deceptive, predatory and to issue any regulations it determines to be necessary or proper to ensure that responsible, affordable credit remains available to consumers.[§ 1405(a)] The Fed also may issue rules modifying or exempting disclosure requirements for any class of residential mortgage loans in order to improve consumer awareness and understanding of mortgage transactions.[§1405(b)]

14.2.6. HUD Study. The HUD Secretary is required to conduct a study, in consultation with the Treasury Secretary, to determine prudent statutory and regulatory requirements to provide for the widespread use of shared appreciation mortgages. The HUD Secretary must complete this study and issue a report to Congress within 6 months of the enactment of the Act. [§1406]

14.3. Minimum Standards for Mortgages.

14.3.1. Ability to Repay Standards. In accordance with regulations to be issued by the Fed, before making a loan, a creditor must make a good faith determination, based on verified and documented information, that the consumer has a reasonable ability to repay the loan and all applicable taxes, insurance and assessments. [§1411] In a case where a creditor has reason to know that there is more than one mortgage on the same property, the creditor must evaluate the consumer's ability to make payments for all mortgages combined.

This evaluation is to include consideration of the consumer's credit history, current income, expected future income, and other sources of funds for repayment. Creditors must meet standards for income verification, including reviewing documents that provide reasonably reliable evidence of the consumer's income or assets. If documented income is a source for repayment, the creditor may consider the seasonality of such income and its irregularity. The creditor must use a fully amortizing repayment schedule for the purposes of determining a consumer's ability to repay a loan.

14.3.1.1. Exemption for Certain Federal Loans. Streamlined refinancing loans made, guaranteed, or insured by certain Federal departments or agencies may be exempted by those agencies from the income verification requirement so long as certain provisions are met. These requirements include that the consumer is not more than 30 days past due on the prior mortgage and the refinancing does not increase the principal balance on the prior mortgage, among others.

14.3.1.2. Nonstandard Loans.

14.3.1.2.1. Variable Rate Loans. The determination of a consumer's ability to repay a variable rate loan that defers repayment of any principal or interest must include a fully amortizing repayment schedule.

14.3.1.2.2. Additional Requirements for Interest-Only Loans. In determining a consumer's ability to repay an interest-only loan, the creditor must use the payment amount required to amortize the loan by its final maturity, and must take into account any payment increases that may result from negative amortization.

14.3.1.2.3. Calculation Process. The Act also contains requirements for the calculation process for the monthly payment amount for principal and interest on any residential mortgage loan. The creditor must assume that the loan proceeds are fully disbursed on the date the loan is consummated, among other requirements.

14.3.1.2.4. Refinancing of Hybrid Loans with Current Lender. When refinancing a hybrid loan into a standard loan, the creditor may consider the borrower's good standing on the existing mortgage and whether the new loan would prevent a likely default should the original mortgage reset, so long as there would be a reduction in the monthly payment and the borrower has not been delinquent on any payment on the existing hybrid loan. In such a circumstance, the creditor may also offer rate discounts and other favorable terms available to new customers with high credit ratings.

14.3.1.2.5. Reverse Mortgages and Bridge Loans. The ability to repay requirements do not apply with respect to a reverse mortgage or bridge loan with a term of 12 months or less, including to any loan to purchase a new dwelling where the consumer plans to sell a different dwelling within 12 months.

14.3.2. Safe Harbor Provision. The Act establishes a rebuttable presumption that, if a loan is a "qualified mortgage," then the consumer has the ability to repay.[§1412]

14.3.2.1. Definition of a "Qualified Mortgage". A qualified mortgage must meet certain criteria, including those described below. Regular periodic loan payments may not result in an increase in the principal or as a general matter allow the consumer to defer repayment of principal. A qualified mortgage also generally may not have balloon payments, which are defined as a scheduled payment that is greater than twice the amount of the average earlier scheduled payments. In order to be a qualified loan, the income and financial resources to qualify for the mortgage must be verified, and the payment schedule must take into account all applicable taxes, insurance, and assessments, among other requirements. The loan must meet any guidelines or regulations established by the Fed relating to debt-to-income, taking into account income level and other factors the Fed may determine relevant. The total points and fees on the loan may not exceed 3 percent of the loan amount.

14.3.2.1.1. Smaller Loans. The Fed is to publish rules adjusting the criteria in order to permit lenders of smaller loans to meet the requirements for the presumption of compliance. The Fed must consider the potential impact of such rules on rural areas and other areas where home values are lower.

14.3.2.1.2. Exemption. Balloon loans may be exempt for some of the requirements for a qualified mortgage, if the creditor determines the consumer can make all scheduled payments, except the balloon payment, out of income or assets other than collateral. Also, the payment schedule must fully amortize the loan over a period of no more than 30 years. Finally, the creditor of such a balloon loan must operate predominantly in rural or underserved areas and must not exceed, with its affiliates, total annual mortgage loan originations to be set by the Fed. The creditor must also keep the balloon loans in its portfolio and meet any asset size threshold or other criteria set by the Fed.

> The Fed may issue regulations adjusting certain requirements of a qualified loan when necessary or appropriate. HUD, the Department of Veteran Affairs, and the Department of Agriculture must issues rules defining the types of loans they insure, guarantee or administer that are qualified mortgages.

14.3.3. Defense to Foreclosure. A consumer may assert violations of the ability to repay standards or the prohibitions against steering as a defense in a foreclosure action and seek a recoupment or set-off for the damages of such a violation. [§1413]

14.3.4. Prohibitions on Certain Prepayment Penalties. Loans that do not meet the requirements for a qualified mortgage may not have prepayment penalties, provided that for this purpose, a qualified mortgage loan does not include a mortgage that has an adjustable rate or a rate exceeding a specified amount in excess of comparable transactions. [§1414]

14.3.4.1. Phasing out of Prepayment Penalties for Qualified Mortgages. Prepayment penalties for qualified mortgages must be limited and phased out after three years of the loan.

14.3.4.2. Option for No Prepayment Penalty. Lenders who offer loans with pre-payment penalties must also offer loans without pre-payment penalties.

14.3.5. Prohibitions on Single-premium Credit Insurance, Mandatory Arbitration, and Waiver of Statutory Causes of Action. Creditors are generally prohibited from direct or indirect financing of single-premium credit insurance. Mortgage loans or home equity lines of credit may not contain mandatory arbitration provisions. Also, mortgage loans may not waive statutory causes of action.

14.3.6. Disclosures Required for Negative Amortization Loans. Creditors of mortgages with negative amortization (other than reverse mortgages) must provide the consumer with disclosure that explains that the transaction will or may result in negative amortization, describes negative amortization, and states that negative amortization increases the principal balance and reduces the consumer's equity. [§1414]

14.3.6.1. Counseling for First Time Homebuyers. First time homebuyers entering into mortgages with negative amortization must receive HUD-certified homeownership counseling.

14.3.7. Notice of Anti-Deficiency Laws. Creditors must also provide notice of any anti-deficiency laws available to the borrower and provide notice before any refinancing that would result in the loss of that protection.

14.3.8. Amendments to TILA Civil Liability Provisions. Civil money penalties for certain penalties under TILA are doubled and the statute of limitations for Section 129 of TILA violations is extended to three years.[§1416]

14.3.9. Lender Rights in the Context of Borrower Deception. A creditor, assignee, or securitizer is exempted from liability and rescission in the case of borrower fraud or deception.[§1417]

14.3.10. Hybrid Adjustable Rate Mortgages. A six-month notice must be provided to the consumer before a hybrid adjustable rate mortgage is reset.[§1418] The Fed may require similar notice for other adjustable rate mortgage loans.

14.3.11. Disclosures. The Act requires creditors to make a series of disclosures, including those discussed below.

14.3.11.1. Required Disclosures for Variable Rate Mortgages with Escrow or Impound Accounts. Creditors must make disclosures for variable rate residential mortgage loans for which an escrow or impound account will be established to pay taxes, insurance and assessments, regarding the amount of monthly payment due for the payment of principal and interest and the amount of such payment deposited in the account for the payment of taxes, insurance and assessments. [§1419]

14.3.11.2. Disclosures for Other Mortgage Loans. Creditors must disclose for all residential mortgage loans the total amount of interest the consumer will pay over the life of the loan, the aggregate amount of fees paid to the mortgage originator in connection with the loan, and the amount paid for settlement services.

14.3.11.3. Disclosures in Monthly Statements. Creditors, assignees, or servicers of a residential mortgage loan must send a monthly statement disclosing the amount of principal remaining on the mortgage, the interest rate on the loan, the next date the interest rate may adjust, any prepayment fee, a description of any late payment fees as well as contact information for home counseling. The Fed may require additional disclosures. Certain fixed rate mortgages are exempted if they provide the obligor with the information in another format. [§1420]

> The Fed must issue regulations for a standard form for the information required in the monthly disclosure.

14.3.12. Comptroller General Study. The Comptroller General must conduct a study to determine the effects that the Act's enactment will have on the availability and affordability of credit for consumers, small businesses, homebuyers and mortgage lending. The Comptroller General must report findings to Congress within a year of the enactment of the Act. The report must include an analysis of whether the credit risk retention provisions of Title IX have significantly reduced risks to the larger credit market. [§1421]

14.3.13. State Attorney Generals. State attorney generals also have increased enforcement authority for certain provisions of TILA, including the new ability to repay requirements.[§1422]

14.4 High-Cost Mortgages. The Act prescribes standards for points and fees related to (i) high-cost mortgages, (ii) open-end consumer credit plans; and (iii) bona fide discount points and prepayment plans.

14.4.1. "High-cost mortgage" Definition Revised. The Act lowers the Home Ownership and Equity Protection Act trigger for high-cost mortgages in TILA. A first mortgage is a high-cost mortgage if the APR exceeds the average prime offer rate by more than 6.5%, which will be published by the Fed and updated weekly (however, if the transaction is for personal property and worth less than $50,000, the APR must exceed the prime offer rate by 8.5% or more).[§1431] A subordinate or junior mortgage with an APR that exceeds the average prime rate by more than 8.5% will also be considered a high-cost mortgage. High-cost mortgages also include mortgages in which the points and fees are greater than 5% for transactions of more than $20,000. For transactions less than $20,000, the threshold is the lesser of 8% of the total transaction or $1,000. Mortgages that allow the creditor to charge or collect prepayment fees for more than 36 months after the transaction closing or where such fees or penalties exceed 2% of the amount prepaid are also considered high-cost.

14.4.2. Balloon Payments. The Act prohibits balloon payments for high-cost mortgages. [§1432(b)]

14.4.3. Additional Requirements for High-Cost Mortgages. Additional requirements for high-cost mortgages include:

- prohibiting creditors from recommending default on an existing debt prior to and in connection with the closing of a high-cost mortgage that refinances such debt;
- prohibiting late payment fees in connection with a high-cost mortgage with certain exceptions;

- prohibiting the acceleration of debt on a high-cost mortgage with certain exceptions;
- prohibiting financing of either a prepayment fee or penalty payable by the consumer if the creditor is the noteholder of the note being refinanced in connection with any high-cost mortgage; and
- prohibiting the charging of any fee to modify, renew, extend or amend a high-cost mortgage and fees for payoff statements, except for a processing fee. [§1433]

14.4.4. Pre-loan Counseling. Borrowers must receive pre-loan counseling before they receive a high-cost mortgage by a HUD-certified counselor or other approved authority. The counselor may not be employed or affiliated with the creditor of the mortgage. The counselor must verify that the consumer has received all information required by the Act. The Fed may prescribe regulations regarding pre-loan counseling.

14.4.5. Corrections and Unintentional Violations. When acting in good-faith, a creditor may make timely corrections and avoid liability for an unintentional violation of the requirements for high-cost mortgages.

14.5. Office of Housing Counseling. The Act also establishes the Office of Housing Counseling in HUD.[§ 1442] The Office will be headed by a Director, appointed by the HUD Secretary.

14.5.1. Purposes. The Office of Housing Counseling will develop programs and activities for homeownership counseling, rental housing counseling, and campaigns to promote housing counseling.

14.5.1.1. Grants for HUD-Certified Counseling Operations. The Office will provide grants to states, local governments, and nonprofit organizations for housing counseling assistance. [§1444] $45 million is appropriated for the 2009 through 2012 fiscal years for the grant program. Programs that receive grants must use HUD-certified counselors. [§1445]

14.5.1.2. Standards for Homeownership Counseling. The HUD Secretary, will set standards for materials used by homeownership counseling services. [§1443]

14.5.1.3. Mortgage Software Systems. The HUD Secretary will also provide certification of mortgage software systems used to evaluate different residential mortgage loan proposals for consumers. The HUD Secretary must also take steps to make sure the software is widely available.

14.5.1.4. National Public Service Multimedia Campaign. The Director will develop a public service campaign for various groups, including those in risk of foreclosure and considering a subprime loan, that it is advisable to obtain unbiased homeownership counseling. The campaign will also promote the availability of such counseling programs, including those sponsored by the HUD Secretary.

14.5.1.5. Foreclosure Rescue Education. The Director of Housing Counseling is to conduct foreclosure rescue education programs in areas that have a high density of foreclosure. Ten percent of the funds appropriated for the national public service campaign must go to the foreclosure rescue education program.

14.5.2. HUD Study on Default and Foreclosure. The HUD Secretary is also required to study the root causes of default and foreclosure of home loans. [§1446] The preliminary study is due 12 months from the date of enactment of the Act, and the final report is due 24 months after enactment.

14.5.3 Default and Foreclosure Database. The HUD Secretary and Director of the Consumer Financial Protection Bureau will establish a database on foreclosures and defaults. [§1447] The database will include information on the number and percentage of delinquent mortgages, the number of mortgage loans that are in foreclosure, and the number of mortgages that are underwater.

14.5.4. Mortgage Information Booklet. The Director of the Bureau will prepare, at least once every 5 years, a booklet to help consumers applying for federally related mortgage loans. [§1450]

14.5.5. Home Inspection Counseling. The HUD Secretary is to publish materials informing potential homebuyers of the availability and importance of obtaining a home inspection.[§1451] HUD-certified counseling services must make these materials available to their clients.

14.5.6. Warnings to Homeowners of Foreclosure Rescue Scams. The Neighborhood Reinvestment Corporation is to use amounts provided under the Housing and Urban Development Act to inform borrowers about the complexity of the foreclosure process and the risk of foreclosure rescue scams.[§1452]

14.6. Mortgage Servicing

14.6.1. Mandatory Escrow and Impound Accounts. Creditors are required, for certain consumer credit transactions, to establish an escrow account for the payment of taxes and hazard insurance, mortgage insurance, and any other required periodic payments or premiums associated with a mortgage loan.[§1461(a)]

14.6.1.1. Duration. The mandatory escrow or impound account shall remain in existence for a minimum period of 5 years from the consummation of the loan, unless and until the borrower has sufficient equity in the dwelling to no longer require mortgage insurance, the borrower is delinquent, the borrower does not comply with certain legal obligations, or the mortgage is terminated.

14.6.1.2. Disclosure for Waiving Borrowers. Creditors must provide specified disclosures to consumers who waive escrow services. [§1462]

14.6.1.3. Exemptions. The Fed may, through regulations, exempt certain creditors from the escrow requirement[§1461]

14.6.1.4. Administration. The escrow or impound account must be administered in accordance with the RESPA, the Flood Disaster Protection Act, and the law of the state where the real property securing the transaction is located. The creditor, if required by state or federal law, is to pay interest to the consumer on the amount in the account.

14.6.1.5. Escrows Included in Repayment Analysis. Any repayment analysis required under TILA will be required to include escrow payments. [§1465]

14.6.2. Restrictions on Obtaining Force-Placed Insurance. Servicers are prohibited from obtaining force-placed hazard insurance unless there is a reasonable basis to believe the borrower has failed to maintain property insurance as require by the loan contract. [§1463]. A servicer must terminate any force-placed insurance within 15 days of receiving confirmation of a borrower's existing insurance coverage.

14.6.3. Requirements for Prompt Crediting of Home Loan Payments. Servicers must promptly credit home loan payments as of the date of receipt, unless a delay in crediting does not result in any charge to the consumer or in the negative reporting to a consumer reporting agency. Consumer payments that are accepted by the servicer but do not meet written requirements for payment must be credited as of 5 days after receipt. Also, a creditor or servicer of a home loan must send an accurate payoff balance within 7 business days after receipt of a written request from the borrower. [§1464]

> The Fed may issue regulations that revise the exemptions for the mandatory insurance, as well as the criteria for the administration of such escrow accounts.

14.7. Appraisal Activities. Title XIV also establishes new appraisal requirements for certain mortgage loans deemed to be higher-risk by the Act.

147.1. Property Appraisal Requirements and Independence Standards.

14.7.1.1. Property Appraisal Requirements. Creditors providing higher-risk mortgages must obtain an appraisal before they extend mortgage credit.[§1471] The

Act specifies appraisal requirements, including a physical property visit and a second appraisal in some circumstances. Creditors must provide the borrower with a free copy of the appraisal, and creditors cannot charge the borrower for the cost of the appraisal. Willful failure by a creditor to obtain an appraisal as required will result in liability for the creditor to the consumer of $2,000.

> Regulations for these appraisal requirements will be jointly issued by the Fed, the OCC, the FDIC, the NCUA, the Federal Housing Finance Agency, and the Bureau. The agencies may exempt a class of loans from the appraisal requirements.

14.7.1.2. Appraisal Independence Requirements. Those with an interest in the underlying transaction of the appraisal may not bribe, coerce, extort, or otherwise inappropriately influence the appraiser. [§1472] Appraisers may not have a financial interest in the transaction involved in the appraisal. Those with an interest in the transaction may not mischaracterize the appraised value of the property.

14.7.1.2.1. Mandatory Reporting. Various entities, such as a mortgage lender or broker, involved in a real estate transaction involving an appraisal must report to the appropriate state licensing agency any violations by an appraiser of the Uniform Standards of Professional Appraisal Practice.

> The Fed shall within 90 days of enactment of the Act provide interim final regulations defining violations of appraisal independence.

Apart from the Fed's interim regulation, the Fed, the OCC, the FDIC, the NCUA, the Federal Housing Finance Agency and the Bureau will have the authority to issue rules and interpretive guidance regarding appraisal independence.

14.7.2. Appraisal Subcommittee of the FFIEC. The Financial Reform, Recovery, and Enforcement Act of 1989 (FIRREA) is amended to provide the Appraisal Subcommittee of the Federal Financial Institutions Examination Council (FFIEC) with a consumer protection mandate. [§1473] The Subcommittee will audit state appraiser regulatory activities.

14.7.2.1. Annual Report. The Subcommittee must send an annual report to Congress detailing its activities and disapproved actions and warnings taken in that year. The Subcommittee may also prescribe regulation in limited areas.

14.7.2.2. Regulations. The Subcommittee may issue limited regulations involving appraisal standards. [§1473(d)]

14.7.3 Supervision of Third Party Providers of Appraisal Management Services. The Fed, the OCC, the FDIC, the NCUA, the Federal Housing Finance Agency, and the Bureau shall jointly establish minimum requirements for states to apply for the registration of appraisal management companies. Mandated requirements include compliance with the Uniform Standards of Professional Appraisal Practice. States may impose additional requirements in addition to the federally mandated standards. States may not register any appraisal management company owned by any person who has had an appraiser license or certificate refused, denied, cancelled, or revoked.

14.7.3.1. Supervision of State Oversight by the Appraisal Subcommittee. The Board of Governors, the OCC, the FDIC, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection will also issue regulations for reporting the activities of appraisal management companies to the Appraisal Subcommittee. The Appraisal Subcommittee will have the responsibility to monitor each state appraiser certifying and licensing agency to ensure that those agencies have policies and practices consistent with federal law that they process complaints on a reasonable basis, among other requirements.

14.7.3.1.1. Reporting Requirement. State agencies dealing with the registration of appraisal management companies are required to transmit reports on the issuance of licenses and certifications, as well as sanctions, to the Appraisal Subcommittee.

14.7.3.1.1. Registration Requirement. Three years after the regulations are published, an appraisal management company may not perform services in a federally related transaction without being registered in that state or subject to oversight by a Federal financial institutions regulatory agency. The Appraisal Subcommittee may extend the three year period by an additional 12 months.

14.7.4. National Appraisal Complaint Hotline. The Appraisal Subcommittee must also establish a national hotline to receive complaints of non-compliance with appraisal standards 6 months after the date of enactment, if such a hotline does not exist at that time. [§1473(p)]

14.7.5. Quality Controls for Automated Valuation Models. Automated valuation standards must adhere to quality control standards designed to protect against the manipulation of data, avoid conflicts of interests, require random sample testing, and any other requirement determined by the agencies drafting the standards. [§1473(q)] These standards will be regulated by the Board of Governors, the OCC, the FDIC, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection.

14.7.6. Broker Price Opinions. Broker price opinions may not be used as the primary basis in determining the value of a piece of property in regards to a mortgage loan secured by that property. [§1473(r)]

14.7.7. Comptroller General Study on Appraisal Process. The Comptroller General is required to study the effectiveness and impact of appraisal methods and other aspects of the appraisal process due no later than 12 months after the date of enactment of the Act. A preliminary report to the House Financial Services Committee and Senate Banking Committee is due 90 days after enactment.[§1476]

14.8. Mortgage Resolution and Modification.

14.8.1. Multifamily Mortgage Resolution Program. The HUD Secretary will develop a program to ensure the protection of multifamily properties and the current and future tenants of such properties. [§1481] The program's objectives will include creating sustainable financing of such properties, maintaining the level of federal state and city subsidies, providing funds for rehabilitation, and facilitating the transfer of such properties to responsible new owners when appropriate.

14.8.1.1 Restrictions for Certain Criminal Applicants. Certain criminal applicants are prohibited from receiving mortgage assistance under the Making Home Affordable Program authorized under the Emergency Economic Stabilization Act of 2008. The HUD Secretary must establish procedures to ensure no such criminal receives such assistance and shall report to the House Financial Services Committee and the Senate Banking Committee on the implementation of this provision.

14.8.2. Adjustments in HAMP Guidelines. Servicers participating in the Home Affordable Modification Program are required to provide each borrower who is denied a mortgage modification the borrower-related and lender-related data used in making a net present value calculation which resulted in denial. [§1482(a)]

14.8.2.1. Public Access to NPV Calculation Data. The Secretary of the Treasury is required to establish an online Net Present Value Calculator which may be used by servicers under the HAMP program. [§ 1482(b)] Treasury is also required to make a reasonable effort to include a method for homeowners to apply for a mortgage modification under the HAMP program on the website. The Secretary is also required to make publicly available the methodology and formulae used in calculating net present value. [§ 1483(c)]

14.8.2.2. HAMP Monthly Reports. Mortgage servicers or lenders participating in the Making Home Affordable Program must report to the Treasury on a monthly basis. [§1483] The Treasury then must post a report on its website on such information within two weeks of receiving it. [§1483(b)] The report must include the number of loan modification requests received, the number of loan modification requests currently being processed and the number of loan modification requests that were approved and denied. The Treasury Secretary has the authority to release publicly other relevant data deemed necessary.

14.8.3. The Protecting Tenants at Foreclosure Act Is Extended to December 31, 2014. The Protecting Tenants at Foreclosure Act was set to expire at the end of 2012, but is now extended through at least December 31, 2014. [§1484]

14.9. Miscellaneous Provisions

14.9.1. Sense of the Congress Regarding Fannie Mae and Freddie Mac. The Act includes a sense of the Congress regarding Fannie Mae and Freddie Mac and states that meaningful structural reform of Fannie Mae and Freddie Mac is necessary. [§1491]

14.9.2. Comptroller General Study. The Comptroller General will study the efforts of the federal government to crackdown on mortgage foreclosure rescue scams and loan modification fraud and make recommendations for further protections. [§1492]

14.9.3. Drywall Study. The HUD Secretary will also conduct a study dealing with drywall that was imported from China from 2004 through 2007 and its impact on residential mortgage loan foreclosures and the availability of property insurance for residential structures in which such drywall is present. The report on that study is due 120 days from the date of enactment. [§1494]

14.9.4. Emergency Mortgage Relief. The HUD Secretary is to provide $1 billion in assistance through the Emergency Homeowner's Relief Fund. [§1496] The Emergency Mortgage Relief Program is also reauthorized.

14.9.4.1. Other Assistance. The HUD Secretary is to provide $1 billion in additional assistance to state and local government for the redevelopment of abandoned and foreclosed homes. [§1497] The HUD Secretary shall also establish a program to provide grants for foreclosure legal assistance to low- and moderate-income homeowners and tenants. [§1498]

# Title XV


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15. Title XV – Miscellaneous Provisions. Title XV contains provisions that address a wide range of topics from a study of the impact of the definitions of core deposit and brokered deposit, to funding for International Monetary Fund ("IMF") loans to heavily indebted countries, to requirements regarding corporate involvement with the conflict minerals trade. For banks, the provision likely to have the greatest eventual impact is the study on brokered deposits (see paragraph 15.5.2, below).

15.1. Restriction on U.S.Funding of IMF Loans to Heavily Indebted Countries. The Treasury Secretary is directed to instruct the U.S. Executive Director at the IMF to evaluate, prior to consideration by the Board of Executive Directors, any proposal submitted to make a loan to a country where (i) the country's public debt exceeds its gross domestic product, and (ii) that country is not eligible for assistance from the International Development Association. The U.S. Executive Director at the IMF is required to oppose the proposal if the evaluation indicates that the proposed loan is not likely to be repaid in full.

If the IMF Board of Executive Directors approves such a loan, the Treasury Secretary is required to produce a report to Congress within 30 days of the approval of the loan, and annually thereafter assessing the likelihood that the loans will be repaid in full, which report will include the borrowing country's debt status; its vulnerabilities that may affect its ability to repay the loan; and its debt management strategy. [§1501]

15.2. Conflict Minerals. The Act declares that it is the sense of Congress that the exploitation and trade of conflict minerals originating in the Democratic Republic of Congo ("Congo") (which minerals are widely used in the production of electronic devices) is helping to finance conflict and contributing to an emergency humanitarian situation warranting, among other things, certain disclosure requirements. This section applies only to those who manufacture a product that relies on "conflict minerals"; this would appear not to include financing activities.

15.2.1. Reporting Requirements. Reporting companies under the Exchange Act for which "conflict minerals" are necessary to the functionality or production of a product manufactured by the company are subject to an annual disclosure requirement in a report submitted to the SEC. The company must describe measures taken to exercise due diligence on the source and chain of custody of such minerals. Reports are also required to describe (i) products manufactured that are not Congo conflict free (*i.e.*, not tied to financing of armed groups within the Congo or an adjoining country) and (ii) facilities used to process the conflict minerals, the country of origin of the conflict minerals, and the efforts to determine the origin of the materials with the "greatest possible specificity." [§1502]

15.2.2. Authority to Revise or Waive Requirements; Termination. The SEC can temporarily revise or waive these requirements if the President transmits to Congress a determination that revision or waiver is in the U.S. national security interest. A waiver can only last for up to two years. Disclosure requirements shall terminate on the date on which the President certifies that no armed groups continue to benefit from commercial activity involving conflict minerals but not less than five years from the date of enactment of the Act.

15.3. Mine Operators Face Greater Health and Safety Reporting Requirements. The Act imposes greater safety-related disclosure requirements on companies operating mines or whose subsidiaries operate mines. Companies that are issuers required to file reports under the Exchange Act must include certain safety information in their future reports. [§1503]

15.4. Resource Extraction Issuers Must Disclose Payments to Governments. Any resource extraction issuer must include in its annual report all payments made to foreign governments or the Federal Government for the purpose of development of oil, natural gas, or minerals. The SEC will issue rules within 270 days of enactment of the Act finalizing the disclosure requirements, but at a minimum, resource extraction issuers will have to state the type and amount of payments for each project made to each government. [§1504]

15.5. Studies.

15.5.1. Study of Inspectors General. The Comptroller General is required to conduct a study of the independence, effectiveness, and expertise of presidentially appointed inspectors general. The study is due within a year of enactment of the Act. [§1505]

15.5.2. Study on Defining Core and Brokered Deposits. The FDIC is required to conduct a study regarding core deposits and brokered deposits. The study is to evaluate (i) the definition of core deposits for the purpose of calculating the insurance premiums of banks; (ii) the potential impact on the Deposit Insurance Fund of revising the definitions of brokered deposits and core deposits to better distinguish between them; (iii) an assessment of the differences of the differences between core deposits and brokered deposits and their role in the economy and the banking sector; (iv) the potential stimulative effect on local economies of redining core deposits; and (v) the competitive parity between large institutions and community banks that could result from redefining core deposits. The study is due within a year of enactment of the Act. This study is likely to continue the trend within the agencies of analyzing the stability of funds with less attention shown to whether the deposit meets current definition of "core" funding. [§1506]

**Title XVI**

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16. Title XVI – Section 1256 Contracts. Title XVI excludes some kinds of swaps and securities futures contracts from the preferential tax treatment of section 1256 of the Internal Revenue Code ("IRC").

16.1. Certain Swaps Not Treated as IRC Section 1256 Contracts. Under section 1256, certain kinds of futures and options contracts are treated as if they are sold at fair market value on the last business day of the tax year. The resulting gain or loss from such sale is favorably treated as 60% long-term capital gain or loss and 40% short-term capital gain or loss. Title XVI excludes certain swaps transactions from this preferential treatment, including (i) interest rate swaps, currency swaps, commodity swaps, equity swaps, equity index swaps, credit default swaps, and similar agreements; and (ii) securities futures contracts or options thereon unless the contract or option is a dealer securities futures contract. The provisions of Title XVI will apply to taxable years following enactment of this Act. [§1601]