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SPECIAL EDITION – IN-DEPTH ANALYSIS

The Dodd-Frank Wall Street Reform and Consumer Protection Act

Introduction

On July 21, 2010 (the “Enactment Date”), President Obama signed into law The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”). The legislative changes mandated by the Act, which is named after Senate Banking Committee Chairman Christopher Dodd (D-Conn.) and House Financial Services Committee Chairman Barney Frank (D-Mass.), are intended to shield the financial system from systemic risk and to address weaknesses in financial services law and regulation that contributed to the severe economic downturn and the related disruption in the financial markets in 2008.

The Act is sweeping in the range of topics it covers, including, to name just a few: (i) the creation of a new regulatory agency that will focus exclusively on the protection of consumers who purchase financial services; (ii) restriction of proprietary trading by banking institutions; (iii) new monitoring and controls of large, systemically significant financial institutions (which include non-banks as well as banks); (iv) heightened capital and liquidity standards for banking institutions and certain other financial institutions; (v) revised and strengthened regulation of trading in derivatives; (vi) federal deposit insurance reform; (vii) changes in investment adviser registration requirements, including elimination of the “private adviser” exemption; and (viii) increased regulation of executive compensation. This Special Edition of the *Financial Services Alert* provides a summary (the “Summary”) of the key provisions of the Act. Despite its length, the Summary does not cover every provision of the Act, and, of course, is not a substitute for a review of the applicable provisions of the Act.

As is frequently the case for regulatory reform legislation of this breadth, the legislation itself is only the starting point. The Act directs various regulatory bodies to draft, adopt and implement more than 240 regulations, many of which will influence dramatically the scope, substance and practical impact of the Act. In addition, the Act calls for the GAO and other agencies to complete an aggregate of almost 70 studies regarding a broad range of issues concerning the financial services industry that were raised during the legislative process. Regulatory bodies may also choose to exercise permissive rulemaking authority granted by Congress without an accompanying mandate under various provisions of the Act.

Accordingly, while some aspects of the Act will be effective immediately, others will take months or years to unfold. Future editions of the *Financial Services Alert* will include more detailed examinations of the different topics covered by the Act and will summarize related regulatory activity and other relevant developments as they occur.

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Table of Contents

I. Banking Reform and Financial Stability	6
A. Regulation of Systemic Risk (Title I).....	6
1. Newly Established Agencies to Regulate Systemic Risk	6
2. Regulation of Systemically Significant Financial Companies	7
3. Regulation of Systemic Risk	10
B. Orderly Liquidation Authority (Title II).....	10
1. Introduction	10
2. Scope	10
3. Designation as Covered Financial Company.....	10
4. Powers of the FDIC	11
5. Claims Process.....	12
6. Qualified Financial Contracts	12
7. Bridge Financial Companies	13
8. Covered Broker-Dealers and Insurance Companies	13
9. Orderly Liquidation Fund.....	14
10. Executives and Directors	14
C. Volcker Rule and Other Prudential Limitations (Title VI).....	14
1. Volcker Rule.....	14
2. Restrictions on Transactions with Affiliates	18
3. Lending Limit Restrictions.....	19
4. Asset Purchases from Insiders	20
D. Strengthened Capital Standards.....	20
1. Leverage and Risk-Based Capital Requirements	20
2. Requirements for Financial Holding Company Status	22
3. Additional Changes to Capital Requirements	22
4. Studies and Reports on Capital.....	22
E. Regulation of Non-Bank Holding Companies	23
1. Ownership of Trust Banks, Credit Card Banks and Industrial Banks	23
2. Savings and Loan Holding Companies	24
F. Supervision of Bank Holding Companies and Thrift Holding Companies	25
G. Elimination of the OTS; Status of Thrift Charter (Title III).....	25
1. Elimination of OTS	25
2. Status of Thrift Charter.....	26
H. FRB, OCC and FDIC Assessment Powers Under Title III	26
I. Changes to Federal Deposit Insurance (Title III, Subtitle C).....	27
1. Permanent Increase in Deposit and Share Insurance	27
2. Change in Deposit Insurance Assessment Calculation.....	27
J. FRB Emergency Lending and FDIC Emergency Financial Stabilization Authorities (Title XI)	27
1. FRB Emergency Lending Authority.....	27
2. FDIC Emergency Financial Stabilization.....	28

K. Changes to Acquisition and De Novo Branching Requirements and Restrictions on Charter Conversions	28
L. Interest-Bearing Transaction Accounts	29
M. Asset-Backed Securities	29
1. Credit Risk Retention	29
2. Additional Securities Law Changes	30
3. Studies	31
4. Conflicts of Interest	31
N. Swaps “Push-out” Rule	31
II. Consumer Financial Protection Reform.....	32
A. Formation and Powers of Bureau of Consumer Financial Protection	32
1. Supervision – Banks	33
2. Preemption/Visitorial Powers.....	34
3. Interchange Fees.....	35
4. Credit Scores	36
5. Remittance Transfers.....	36
6. Enforcement and Remedies	36
B. Supervision of Nondepository Institutions	36
C. Mortgage Loan Regulatory Provisions (Title XIV)	37
1. Residential Mortgage Loan Origination	37
2. Minimum Mortgage Standards.....	38
3. High Cost Mortgages.....	38
4. Office of Housing Counseling.....	38
5. Mortgage Servicing	38
6. Appraisal Requirements	39
7. Mortgage Resolution and Modification.....	39
8. Other Provisions	39
D. Improving Access to Mainstream Financial Institutions (Title XII)	40
1. Expanded Access to Mainstream Financial Institutions.....	40
2. Low-Cost Alternatives to Small Dollar Value Loans.....	40
3. Grants to Establish Loan-Loss Reserve Funds	40
E. Pre-Dispute Arbitration and Specific Bureau Authorities (Title XII)	41
1. Pre-Dispute Arbitration	41
2. Specific Bureau Authorities.....	41
F. Mortgage Reform and Predatory Lending Act (Title XIV).....	42
1. Ability to Repay	42
2. Defense to Foreclosure	44
3. Prepayment Penalties.....	44
4. Single Payment Credit Insurance	44
5. Arbitration Agreements	44
6. Negative Amortization Loans.....	45
7. Anti-Deficiency Protections	45
8. Partial Payments	45
9. Increase to Civil Liability Provisions	45
10. Lender Rights for Borrower Deception	45

11. Hybrid Adjustable Rate Mortgages	45
12. Required Disclosures at Consummation.....	46
13. Required Disclosures in Monthly Statements	46
14. Report by the GAO.....	46
G. Enforcement Powers of the Bureau (Title X, Subtitle E)	46
1. Investigations and Administrative Discovery.....	46
2. Hearings and Adjudication Proceedings.....	47
3. Litigation Authority	48
4. Relief Available.....	48
5. Other Enforcement	49
III. Payment, Clearing and Settlement Supervision (Title VIII).....	49
A. Designated Financial Market Utilities and Designated Activities.....	49
B. Risk Management Standards	50
C. Access to the Discount Window.....	50
D. Advance Notice of Proposed Changes	50
E. Examination and Enforcement	50
F. Reporting Requirements.....	51
IV. Advisers Act Amendments Including Elimination Of Private Adviser Exemption (Title IV).....	51
A. Changes to Advisers Act Exemptions/Exclusions.....	51
B. New \$100 Million Threshold for SEC Registration.....	51
C. Recordkeeping and Reporting	51
D. Information Sharing Regarding Private Funds.....	52
E. Effectiveness	52
V. Derivatives	52
A. Parallel Regimes for Swaps and Security-Based Swaps	52
B. Certain Key Derivatives Market Participants Subject to New Standards.....	52
C. Swap and Security-Based Swap Dealers and Major Swap and Security-Based Swap Participants Subject to Registration, Capital and Reporting Requirements	53
D. Obligations to Counterparties and Duties to Special Entities.....	53
E. Mandatory Clearing and Exchange Trading; Additional Capital and Margin Requirements for Uncleared Contracts.....	53
F. Clearing Agencies, Derivatives Clearing Organizations and Swap Repositories	54
G. Mandatory Transaction Reporting.....	54
H. Position Limits	54
I. Extraterritoriality; International Cooperation.....	54

VI. Executive Compensation.....	54
A. Shareholder Approval of Executive Compensation (Say on Pay).....	54
B. Compensation Committee Independence	55
C. Executive Compensation Disclosures	55
D. Recovery of Erroneously Awarded Compensation	55
E. Disclosure Regarding Employee and Director Hedging	56
F. Enhanced Compensation Structure Reporting.....	56
G. Voting by Brokers	56
VII. Corporate Governance.....	56
VIII. Other Securities Regulation Reform	57
A. Regulation D.....	57
B. Broker-Dealer and Adviser Standard of Care and Oversight	58
1. Broker-Dealer and Investment Adviser Standards of Conduct	58
2. Disclosure, Sales Practices, Conflicts of Interest and Compensation Schemes.....	58
C. Securities Litigation	58
1. SEC Authority to Restrict Pre-Suit Arbitration	59
2. Whistleblower Provisions.....	59
3. Expanded Scope of Collateral Bars	59
4. Nationwide Service of Subpoenas	59
5. Aiding and Abetting	59
6. Extraterritoriality of Antifraud Provisions	60
7. Audits of Foreign Accountants.....	60
8. Shared Government Privilege.....	60
9. Control Person Liability	60
10. Other Provisions	60
D. Credit Rating Agencies	61
1. Internal Control	61
2. Compliance Officer and Board.....	61
3. SEC Oversight.....	61
4. Rulemaking - Methodology, Conflicts of Interest, Disclosure.....	61
5. Liability	61
E. Miscellaneous Securities Regulation Topics.....	62
1. Custody - Advisers and Registered Funds.....	62
2. Qualified Client Dollar Thresholds	62
3. Advisers Act Definitions	62
4. Removal of Credit Ratings from Agency Rules	62
5. Deadlines for SEC Examinations and Investigations	62
6. Section 13 and Section 16 Reporting	63
7. Short Sales	63
8. Securities Lending.....	63
9. Studies	63

IX. Federal Insurance Office (Title V)	63
1. Functions	64
2. Reports.....	64
3. Preemption.....	64
4. Information Collection	64
X. International Regulatory Oversight and Coordination	65

I. Banking Reform and Financial Stability

A. Regulation of Systemic Risk (Title I)

In response to the financial crisis, the Act creates a new supervisory regime designed to monitor and regulate systemic risk in the U.S. financial system. Banking organizations subject to this new regime are referred to in this Summary as “Systemically Significant Bank Holding Companies”; other companies subject to the new regime are referred to as “Systemically Significant Nonbank Financial Companies;” and together such companies are referred to as “Systemically Significant Financial Companies.”

1. Newly Established Agencies to Regulate Systemic Risk

(a) Financial Stability Oversight Council.

The Act establishes the Financial Stability Oversight Council (the “Council”) to identify systemic risks to the financial stability of the United States, end the expectation that some institutions are “too big to fail” and respond to emerging threats to the U.S. financial system. The Council is composed of ten voting members and five non-voting members. The ten voting members of the Council are the Treasury Secretary (who serves as the chair of the Council), the FRB Chairperson, the Comptroller of the Currency, the Bureau of Consumer Financial Protection (“Bureau”) Director, the SEC Chairperson, the FDIC Chairperson, the CFTC Chairperson, the FHFA Director, the NCUA Chairperson and an independent member having insurance expertise appointed by the President with the advice and consent of the Senate. The five non-voting members of the Council are the Office of Financial Research (“OFR”) Director, the Federal Insurance Office (“FIO”) Director, a state insurance commissioner, a state banking supervisor and a state securities commissioner.

The Council will collect information to assess risks to the U.S. financial system, monitor systemic risks and identify regulatory gaps. The Council will facilitate information sharing among its members and other state and federal agencies as well as coordinate general supervisory priorities and principles among its members and resolve disputes between them. The Council is also responsible for identifying Systemically Significant Nonbank Financial Companies to be supervised by the FRB and systemically important financial market utilities (discussed further below). The Council may make recommendations to the financial regulatory agencies concerning heightened prudential standards for Systemically Significant Financial Companies or to the SEC and the Financial Accounting Standards Board regarding existing or proposed accounting principles and standards. The Council may also make recommendations regarding new or heightened and broadened prudential standards and safeguards for activities the Council determines create systemic risk

(including payment, clearing and settlement activities, as discussed below) regardless of the size of the financial company participating in such activities.

(b) Office of Financial Research

The Act establishes the OFR as a largely independent, self-funded (through fees on Systemically Significant Financial Companies) agency within the U.S. Treasury Department, to serve as the information gathering arm of the Council. The OFR has broad powers, including subpoena authority, to gather information and require reports from all financial companies. The information collected by the OFR is subject to the Freedom of Information Act.

2. Regulation of Systemically Significant Financial Companies

(a) Systemically Significant Bank Holding Companies

Bank holding companies with \$50 billion or more in assets are subject to the heightened and broadened prudential standards and other requirements of the Act for Systemically Significant Financial Companies. In order to prevent certain companies from deregistering as bank holding companies to avoid the systemically significant designation, the Act provides (Section 117) that any entity that was a bank holding company with assets of \$50 billion or greater on January 1, 2010 and received financial assistance under the Capital Purchase Program will be automatically treated as a Systemically Significant Nonbank Financial Company should it cease to be a bank holding company. Foreign banks and bank holding companies may be designated as Systemically Significant Bank Holding Companies.

(b) Systemically Significant Nonbank Financial Companies

As discussed above, the Council (Section 113), by a 2/3 vote, may designate a nonbank financial company as a Systemically Significant Nonbank Financial Company subject to regulation by the FRB, including heightened and broadened prudential standards and other restrictions. To be considered a nonbank financial company, 85% or more of the company's annual gross revenues or consolidated assets must be related to activities that are predominantly financial in nature, as defined by section 4(k) of the Bank Holding Company Act (the "BHC Act") or related to ownership or control of an insured depository institution. The definition of nonbank financial company excludes certain companies, including Farm Credit institutions, national securities exchanges, clearing agencies, security-based swap execution facilities and data repositories, and boards of trade designated as contract markets. To be designated as systemically significant, the Council must determine that the failure, nature, scope, size, scale, concentration, interconnectedness or mix of activities of the nonbank financial company could pose a threat to the financial stability of the United States. The factors that the Council must consider when making such a determination include the company's leverage, the nature of the assets and liabilities of the company, the company's reliance on short-term funding, the nature of the company's activities, its interconnectedness with other Systemically Significant Financial Companies and its importance as a source of credit and liquidity. Unlike Systemically Significant Bank Holding Companies, there is no asset threshold for Systemically Significant Nonbank Financial Companies. The designation that a company is a Systemically Significant Nonbank Financial Company is subject to notice and hearing procedures and judicial review. Foreign nonbank financial companies may be designated as Systemically Significant Nonbank Financial Companies.

Upon the determination that a nonbank financial company is a Systemically Significant Nonbank Financial Company, the FRB may require such a company to establish an intermediate holding company through which to conduct its financial activities, and the Act mandates that the FRB impose such a requirement in certain circumstances. The Act (Section 167(b)) requires the parent company of such an intermediate holding company to act as a source of strength to the intermediate holding company.

Systemically Significant Nonbank Financial Companies are subject to supervision by the FRB, including reporting requirements, examinations and enforcement actions. Systemically Significant Nonbank Financial Companies are treated as bank holding companies for purposes of the Depository Institutions Management Interlocks Act (Section 164). As discussed in greater detail below, Systemically Significant Nonbank Financial Companies are subject to restrictions on proprietary trading and investments and sponsorship of hedge funds and private equity funds.

(c) Heightened and Broadened Prudential Standards and Other Requirements for Systemically Significant Financial Companies

(i) Heightened and Broadened Prudential Standards

Under the Act, Systemically Significant Financial Companies are subject to heightened and broadened prudential standards. The Council (Section 115) may make recommendations regarding these heightened and broadened standards, however, the FRB will promulgate and enforce such standards and has supervisory authority over all Systemically Significant Financial Companies. Generally, the FRB must issue the regulations implementing such standards by January 21, 2012. The FRB is required (Section 165) to prescribe heightened and broadened prudential standards for Systemically Significant Financial Companies, including risk-based capital requirements and leverage limits, liquidity requirements, risk management requirements, resolution plan and credit report requirements and concentration limits. Such standards must be more stringent than the prudential standards for other financial companies, including the capital and leverage standards discussed below. The Act further requires that Systemically Significant Financial Companies include off-balance sheet activities in their computations of capital for purposes of meeting such capital standards. The Council must submit a report regarding the feasibility, benefits, costs and structure of a contingent capital requirement for Systemically Significant Financial Companies by July 21, 2012. Subject to this report, the FRB is authorized to require that Systemically Significant Financial Companies maintain a minimum amount of contingent capital that is convertible to equity “in times of financial stress.”

In order to limit the risk profile of Systemically Significant Financial Companies, the FRB must establish (Section 165) credit exposure concentration limits and may establish short-term debt limits for Systemically Significant Financial Companies. Upon the determination of the Council that a Systemically Significant Financial Company poses a grave threat to U.S. financial stability, the FRB must require such company to maintain a debt to equity ratio of no greater than 15 to 1. The Act further requires the FRB, in conjunction with other appropriate regulators, to conduct annual stress tests of Systemically Significant Financial Companies that are designed to evaluate whether such companies have enough capital, on a consolidated basis, to absorb projected losses in the event of adverse economic conditions.

(ii) Other Requirements

The Act requires (Section 165) Systemically Significant Financial Companies to submit resolution plans and periodic credit exposure reports to the FRB, and the Council, through the OFR, may require (Section 116) periodic certified reports from Systemically Significant Financial Companies or their subsidiaries relating to such company's financial condition, risk monitoring systems, transactions with depository institution affiliates, and the extent that, under adverse conditions, its activities and operations could disrupt financial markets or U.S. financial stability. Moreover, as discussed below, in order to limit potential conflicts of interest, the Act (Section 726) authorizes the CFTC to limit the control of derivatives clearing organizations, swap execution facilities or boards of trade designated as contract markets by Systemically Significant Financial Companies.

The Act restricts the ability of certain Systemically Significant Financial Companies to make a significant acquisition without first obtaining the approval of the FRB (Section 163). Specifically, a Systemically Significant Financial Company with total consolidated assets of \$50 billion or more must provide notice to and obtain approval from the FRB in accordance with the procedures set forth at Section 4(j) of the BHC Act (except that the exception from such notice requirement provided by Section 4(j)(3) is inapplicable) before acquiring direct or indirect ownership or control of any voting shares of any company (other than an insured depository institution) with \$10 billion or greater in assets that is engaged in activities described in Section 4(k) of the BHC Act (e.g., financial activities). In addition to the standards for review described in Section 4(j)(2) of the BHC Act, the FRB must consider the extent to which the proposed acquisition would result in greater or more concentrated risks to global or U.S. financial stability before determining whether to approve or disapprove a notification. Financial holding companies with total assets of \$50 billion or more will also be subject to this notice requirement. The Act also provides that transactions subject to this notification requirement are subject to Hart-Scott-Rodino filing requirements, regardless of the exception for transactions for which FRB approval is required. Transactions involving an acquisition of an interest in an insured depository institution remain subject to applicable requirements of the BHC Act, the Home Owners' Loan Act (the "HOLA") and the Federal Deposit Insurance Act (the "FDIA").

(iii) Mitigation Authority

The Act requires (Section 166) the FRB, in consultation with the Council and the FDIC, to prescribe regulations requiring the early remediation of distressed Systemically Significant Financial Companies. The Act also provides (Section 121) that if the FRB determines that a Systemically Significant Financial Company poses a grave threat to U.S. financial stability, upon a 2/3 vote of the Council, the FRB may limit such company's ability to merge with or acquire another company, restrict such company's ability to offer a financial product or products, require such company to terminate one or more activities, impose conditions on the activities of such company, or require the company to sell or otherwise transfer assets or off-balance sheet items to unaffiliated entities.

The FDIC is authorized (Section 172) to examine Systemically Significant Financial Companies in order to determine the condition of any such company for purposes of implementing its authority under Title II of the Act, which is discussed further below.

3. Regulation of Systemic Risk

As discussed above, the Council may recommend (Section 120) new or heightened prudential standards and safeguards for activities the Council determines create systemic risk. Such standards with respect to such a systemically significant financial activity could be similar to the heightened and broadened prudential standards imposed generally on Systemically Significant Financial Companies; however, such standards would apply to any bank holding company or nonbank financial company subject to the jurisdiction of a member of the Council, regardless of size. In order to designate a financial activity as systemically significant, the Council must determine that the conduct, scope, nature, size, scale, concentration, or interconnectedness of the activity or practice could create or increase the risk of significant liquidity, credit or other problems spreading among bank holding companies and nonbank financial companies, U.S. financial markets or low-income, minority or underserved communities. In addition, the Act (Section 123) requires the Council to study the effects of size and complexity of financial institutions on capital market efficiency and economic growth and regularly report to Congress the findings of such study.

B. Orderly Liquidation Authority (Title II)

1. Introduction

The orderly liquidation authority provisions set forth in Title II of the Act give the Treasury Secretary the ability (“Liquidation Authority”) to resolve the failure of a “covered financial company” in the United States by appointing the FDIC as receiver for such a company. As receiver, the FDIC has powers and duties with respect to such company that are similar to those granted to it to resolve depository institutions under the FDIA. Such a receivership conducted under the Liquidation Authority must terminate within certain time limits.

2. Scope

The Treasury Secretary may utilize the Liquidation Authority with respect to any covered financial company. The term “financial company” is defined as any company that is incorporated or organized under U.S. federal or state law that is: (a) a bank holding company, as defined by the BHC Act; (b) a Systematically Significant Nonbank Financial Company, including an insurance company or a securities broker-dealer; (c) any company that is predominantly engaged in activities that are financial in nature or incidental thereto, as such term is defined in Section 4(k) of the BHC Act (“financial activities”); or (d) any subsidiary of any of the foregoing that is predominantly engaged (at least 85%) in financial activities other than a subsidiary that is an insured depository institution or an insurance company. There is an exclusion for certain governmental entities.

3. Designation as Covered Financial Company

Covered Financial Company. A financial company (other than a broker-dealer or an insurance company, as discussed below) will be designated as a covered financial company, and the FDIC will be appointed as its receiver, if at any time the Treasury Secretary makes the following determinations, upon the recommendation of 2/3 of the Governors of the FRB and 2/3 of the FDIC Board, and in consultation with the President: (a) the financial company is in default or in danger of default; (b) the failure of the financial company and its resolution under otherwise applicable insolvency law would have serious adverse effects on financial stability in the United States; (c) no viable private sector alternative is available to prevent the default of the financial company; (d) any effect of using the Liquidation

Authority on the claims or interests of creditors, counterparties and shareholders of the financial company and other market participants would be appropriate given the beneficial impact of using the Liquidation Authority on U.S. financial stability; (e) the use of the Liquidation Authority would avoid or mitigate the adverse effects that would result from resolving the financial company under otherwise applicable insolvency law; (f) a Federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments that are subject to being converted by regulatory order; and (g) the company satisfies the definition of “financial company” as described above. The Treasury Secretary must obtain an order from the U.S. District Court for the District of Columbia before appointing the FDIC as receiver of any covered financial company unless the financial company’s board of directors acquiesces or consents to the appointment.

If the FDIC is appointed as receiver of a covered financial company, it may appoint itself as receiver of any subsidiary of the covered financial company, other than an insured depository institution, insurance company or covered broker-dealer, if the FDIC and the Treasury Secretary jointly make certain determinations regarding the probability of default and the significance of the subsidiary.

Effect of Appointment of FDIC as Receiver. With the exceptions described below regarding covered broker-dealers or covered insurance companies, the FDIC will apply the provisions of the Liquidation Authority instead of applicable insolvency law in connection with liquidating any covered financial company. If the FDIC is appointed as receiver, it succeeds to all of the rights and obligations of the covered financial company subject to the provisions of the Liquidation Authority. The Liquidation Authority will apply whether or not the appointment of the FDIC as receiver occurs before or after the commencement of bankruptcy proceedings.

4. Powers of the FDIC

Core Resolution Powers, Merger and Transfer. The FDIC, acting as receiver, will have full powers to operate the covered financial company throughout the period of the receivership. The FDIC also has the power to transfer all or any portion of the assets or liabilities of the financial company to a third party or a bridge financial company, or to merge the covered financial company with any other company, in each case without consent or review.

Financial Assistance. The FDIC may provide a wide range of financial assistance in connection with the resolution of a covered financial company, including making loans to, or purchasing debt, purchasing assets, assuming or guaranteeing obligations, taking liens on assets, and selling or transferring assets or liabilities of, the covered financial company, subject to an orderly liquidation plan approved by the Treasury Secretary and certain other conditions.

Ipso Facto Clauses. Ipso facto clauses are not enforceable against the FDIC in its capacity as receiver, except in the case of qualified financial contracts (“QFCs”), director or officer liability insurance contracts and depository institution bonds.

Repudiation of Contracts. The FDIC, acting as receiver, has the right to disaffirm or repudiate any contract or lease, including a QFC, to which a covered financial company in receivership is a party if the FDIC determines within a reasonable period of time that the contract would be burdensome and repudiation of the contract would promote the orderly

administration of the covered financial company's affairs. If the FDIC disaffirms or repudiates a contract, the counterparty would have a claim against the receivership estate for actual direct compensatory damages, with certain exceptions.

Preferential or Fraudulent Transfers. The FDIC, acting as receiver, may set aside a security interest or other transfer of property if it amounts to a preferential or fraudulent transfer under standards set forth in the Act.

5. Claims Process

The Act requires the FDIC, acting as receiver, to administer an orderly claims process.

Power to Temporarily Stay Litigation. The FDIC may request a stay of up to 90 days of any judicial action or proceeding to which a covered financial company in receivership is or becomes a party, and the relevant court is required to grant such stay.

Maximum and Minimum Payments on Claims. Generally, each creditor of a covered financial company that is in receivership is entitled to receive no more and no less than it would have received in a liquidation under Chapter 7 of Title 11 of the United States Code (the "Bankruptcy Code"). However, the FDIC is authorized to pay more than the minimum on any claim in order to minimize any losses to the FDIC, provided that no payment on a claim may exceed the face amount of such claim.

Priority of Claims and Set-Off. Subject to the modifications discussed below, unsecured claims that are proved to the satisfaction of the receiver will be given priority according to a ranking established by the Liquidation Authority. Claims of creditors with otherwise enforceable setoff rights will rank senior to general unsecured claims to the extent the FDIC destroys the mutuality of any offsetting claims by transferring one of the otherwise offsetting claims to a third party or bridge financial company. Post-receivership financing incurred by the FDIC on behalf of a covered financial company will rank senior to all other unsecured claims. Claims of similarly situated creditors shall be treated in a similar manner, provided that the FDIC may treat similarly situated creditors differently as necessary to achieve certain FDIC objectives. The priority structure shall not affect the rights of secured creditors. The Liquidation Authority generally recognizes the enforceability of setoff rights subject to certain conditions.

6. Qualified Financial Contracts

QFCs include securities contracts, commodity contracts, forward contracts, repurchase agreements, swap agreements and master agreements for any of the foregoing. QFCs receive special treatment under the Liquidation Authority. The FDIC has the option to transfer all, but not less than all, of the QFCs between a covered financial company and a particular counterparty and its affiliates to a single third-party financial institution. If the FDIC exercises this option, the counterparty is not permitted to terminate, accelerate or otherwise exercise its rights to close out the contract solely by virtue of the FDIC's appointment as receiver, the insolvency of the covered financial company or the transfer to the third party or bridge financial company. However, the counterparty may exercise such close-out rights upon the occurrence of another type of default. Furthermore, if the FDIC does not transfer all such QFCs, the counterparty may, after 5:00 p.m. on the business day following the date of the appointment of the FDIC as receiver, terminate, accelerate or otherwise exercise its rights to close out such a contract solely by virtue of such appointment. An otherwise enforceable and perfected security interest that collateralizes a

QFC obligation may not be set aside unless the security interest was taken with intent to defraud.

7. Bridge Financial Companies

The Act authorizes the FDIC to establish one or more companies known as a bridge financial company in connection with a receivership. A bridge financial company has the authority to purchase assets and assume liabilities from a covered financial company free of equity interests. A bridge financial company will operate under the management of a board of directors appointed by the FDIC. 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 apply in connection with the transfer of assets and liabilities to a bridge financial company. A bridge financial company is authorized to obtain unsecured credit, and, subject to certain conditions and procedures, issue secured and senior secured debt. 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. Bridge financial company status is subject to statutory duration limits.

8. Covered Broker-Dealers and Insurance Companies

Determination of Covered Financial Company Status. If a financial company is a securities broker-dealer or its largest U.S. subsidiary is a securities broker-dealer, the designation as a covered financial company must be recommended by 2/3 of the Commissioners of the SEC and 2/3 of the Governors of the FRB, and the FDIC must be consulted. If the financial company is an insurance company or its largest U.S. subsidiary is an insurance company, the designation must be approved by the Director of the FIO and 2/3 of the Governors of the FRB, and the FDIC must be consulted.

SIPC As Trustee. In the case of a covered financial company that is an SEC-registered broker-dealer and a member of the Securities Investor Protection Corporation (“SIPC”), the FDIC must appoint SIPC as trustee for the liquidation of the covered broker-dealer under the Securities Investor Protection Act (“SIPA”). However, the FDIC will have control over the orderly liquidation of any assets or liabilities transferred to a bridge financial company. Counterparty rights on QFCs with the covered broker-dealer will be governed by the Liquidation Authority and not by SIPA.

SIPC’s Powers and Duties. Except as provided in the Liquidation Authority, SIPC would have the same powers and duties with respect to a covered broker-dealer that it would otherwise have under SIPA. SIPC would not be permitted to exercise its powers under SIPA in a manner that impedes or impairs the FDIC’s major powers and objectives under the Liquidation Authority.

Satisfaction of Customer Claims. SIPC, the FDIC or the bridge financial company, as applicable, is required to promptly discharge all obligations of a covered broker-dealer or any bridge financial company to customers in the same manner as in a proceeding under SIPA. SIPC is required to pay all other types of claims in accordance with the priority rules under the Liquidation Authority.

Insurance Companies. The liquidation or rehabilitation of any insurance company that itself is, or is the subsidiary of, a covered financial company would be carried out by the

appropriate state regulator under applicable state law, rather than the FDIC under the Liquidation Authority, unless such regulator fails to do so in a timely manner.

9. Orderly Liquidation Fund

The FDIC may borrow funds from the Treasury's Orderly Liquidation Fund to carry out its mission under the Liquidation Authority. The FDIC may fund the costs of resolving a covered financial company by issuing limited amounts of debt securities to the Treasury. The FDIC is required to repay its borrowings from Treasury by, if necessary, imposing assessments as follows: (a) as soon as practicable on any claimant that received payments that exceed the minimum amounts described above, subject to certain exceptions; (b) if such amounts are insufficient, on eligible financial companies and other financial companies with total consolidated assets of \$50 billion or more.

In imposing any assessments on eligible financial companies and other large financial companies, the FDIC must use a risk matrix as recommended by the Council. The risk matrix shall take into account a number of factors, such as the risk presented by the financial company to U.S. financial stability and the prevailing economic conditions. The FDIC may not use any of its funding as receiver for any covered financial company unless subject to an orderly liquidation plan acceptable to the Treasury Secretary. The Liquidation Authority prohibits taxpayer funds from being used to prevent liquidation of a covered financial firm.

10. Executives and Directors

Directors and executive officers of a covered financial company may be held personally liable for monetary damages in any civil actions by the FDIC with respect to gross negligence or a greater disregard of a duty of care. The FDIC is permitted to recover from senior executives or directors substantially responsible for the failed condition of a covered financial company any compensation received during the two year period prior to the date the FDIC is appointed as receiver. In the case of fraud committed by such executive or director, no such time limit will apply. The FRB or the FDIC are permitted to ban a senior executive or director of a covered financial company from participation in the financial industry for a period of time if such executive or director benefited from certain illegal, unsafe, or dishonest acts which contributed to the failure of the company.

C. Volcker Rule and Other Prudential Limitations (Title VI)

1. Volcker Rule

The Act (Section 619) amends the BHC Act to add a new Section 13 to the BHC Act that bars banking organizations from engaging in proprietary trading and sponsoring and investing in hedge funds and private equity funds, except as permitted under certain limited exceptions. This provision has become commonly known as the "Volcker Rule."

(a) Banking Entities Subject to the Volcker Rule's Restrictions

The bar on proprietary trading and sponsoring and investing in private equity funds and hedge funds applies to banking entities. BHC Act § 13(h)(1) defines a "banking entity" as:

- Any insured depository institution, as defined in Section 3 of the FDIA;
- Any company that controls an insured depository institution;

- Any company treated as a bank holding company for purposes of Section 8 of the International Banking Act of 1978, as amended; and
- Any affiliate or subsidiary of such a company.

Systemically Significant Nonbank Financial Companies are not automatically subject to the bars on proprietary trading and sponsoring and investing in hedge funds and private equity funds (unless such companies are otherwise described in the definition of banking entity). However, BHC Act § 13(f)(4) requires the appropriate Federal banking agencies, the SEC and the CFTC to adopt rules imposing additional capital charges or other restrictions for Systemically Significant Nonbank Financial Companies to address the risks to and conflicts of interests of banking entities addressed by the Volcker rule. BHC Act § 13(h)(1) contains an important exception for companies that control an insured depository institution that “functions solely in a trust or fiduciary capacity” and that meets certain requirements identical to those currently contained in Section 2(c)(2)(D) of the BHC Act.

(b) Definition of Proprietary Trading

BHC Act § 13(h)(4) defines “proprietary trading”, when used with respect to a banking entity or Systemically Significant Nonbank Financial Company, as “engaging as principal for the trading account of the banking entity or nonbank financial entity 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], and the [CFTC] may, by rule . . . determine.” For this purpose, BHC Act § 13(h)(6) defines a “trading account” as any account used for acquiring or taking positions in the securities or instruments referenced in the definition of “proprietary trading” “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), and any such other accounts as the appropriate Federal banking agencies, the [SEC] and the [CFTC] may by rule...determine.”

(c) Exceptions to the Bar on Proprietary Trading and Investment Activities that do not Constitute Proprietary Trading

BHC Act § 13(d) would permit certain types of activities, including the following:

- The purchase, sale, acquisition or disposition of obligations of the U.S. or any agency thereof and certain government-sponsored entity obligations;
- The purchase, sale, acquisition or disposition of securities and other instruments referenced in the definition of proprietary trading in connection with underwriting or market making related activities, to the extent that any such activities are designed not to exceed the reasonably expected near term demands of clients, customers or counterparties;
- Risk mitigating hedging activities;
- Trading on behalf of customers;
- Investments in small business investment companies, community welfare investments of the type permissible for national banks pursuant to Section 24(Eleventh) of the

National Bank Act, and qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure;

- Certain investments by or on behalf of insurance companies;
- Certain trading by foreign companies outside of the United States; and
- Other activities permitted by regulation.

(d) Definition of Hedge Fund and Private Equity Fund

BHC Act § 13(h)(2) defines the terms “hedge fund” and “private equity fund” as any issuer that would be an investment company, as defined in the 1940 Act, but for Section 3(c)(1) (not more than 100 investors) or Section 3(c)(7) (qualified purchasers) of the 1940 Act, or such similar funds as the appropriate Federal banking agencies, the SEC and the CFTC designate by regulation.

(e) Definition of to “Sponsor” a Hedge Fund or Private Equity Fund

BHC Act § 13(h)(5) defines the term to “sponsor” a fund as to (i) serve as general partner, managing member or trustee of the fund, (ii) in any manner to select or control (or to have employees, officers or directors or agents who constitute) a majority of the directors, trustees, or management of the fund, or (iii) to share with the fund for corporate, marketing, promotional or other purposes, the same name or a variation of the same name.

(f) Exceptions to the Prohibition on Sponsoring and Investing in Hedge Funds and Private Equity Funds

BHC Act § 13(d) permits certain activities, including the following:

- The organizing and offering of a private equity or hedge fund in connection with certain fiduciary activities;
- Investments in certain funds by a foreign company outside of the United States;
- Making a de minimis investment in a hedge fund or private equity fund that the banking entity organizes and offers; and
- Other activities permitted by regulation, following a determination that such activities would promote and protect the safety and soundness of the banking entity and the financial stability of the United States.

(g) Other Restrictions or Requirements with Respect to Permitted Activities

A banking entity may only engage in activities excepted from the bar on proprietary trading and sponsoring or investing in hedge funds or private equity funds if otherwise authorized to do so under applicable law. In addition, under BHC Act § 13(d)(1), the appropriate federal banking agencies, the SEC and the CFTC may impose “restrictions or limitations” on permitted activities as they “may determine.”

Even if an activity is otherwise permitted under the exceptions described above and authorized under otherwise applicable law, BHC Act § 13(d)(2) would provide that no

activity is permissible if (i) it would involve or result in a material conflict of interest (as defined by rulemaking) between the banking entity and its clients, customers or counterparties, (ii) would result in material exposure by the banking entity to “high-risk assets” or “high-risk trading strategies” (these terms are not defined in the Act but are to be defined by regulation); (iii) would pose a threat to the safety and soundness of the banking entity, or (iv) would pose a threat to the financial stability of the United States.

In addition, BHC Act § 13(d)(3) requires the appropriate Federal banking agencies, the SEC and the CFTC to adopt rules imposing additional capital requirements and quantitative limitations, including diversification requirements, regarding the activities permitted under BHC Act § 13 if they determine that such requirements and limitations are appropriate to protect the safety and soundness of banking entities engaged in such activities.

(h) Other Restrictions on Relationships between a Banking Entity or a Nonbank Financial Company Supervised by the Board and a Hedge Fund or Private Equity Fund

BHC Act § 13(f)(1) provides that a banking entity that serves, directly or indirectly, as the investment manager, investment adviser, or sponsor to a hedge fund or private equity fund and its affiliates may not enter into a transaction with any such fund or any hedge fund or private equity fund controlled by such fund that would be a “covered transaction” for purposes of Section 23A of the Federal Reserve Act, applied as if such banking entity or affiliate were a member bank and such fund were an affiliate.

(i) Anti-Evasion

BHC Act § 13(e)(2) provides that whenever an appropriate Federal banking agency, the SEC or the CFTC has reasonable cause to believe that a banking entity or Systemically Significant Nonbank Financial Company supervised by the FRB under the respective agency’s jurisdiction has made an investment or engaged in an activity in a manner that functions as an evasion of the requirements of BHC Act § 13 (including through abuse of any permitted activity) or otherwise violates the restrictions under BHC Act § 13, it shall order (after due notice and opportunity for hearing) the banking entity to terminate the activity and, as relevant, dispose of the investment.

(j) Rulemaking Process and Effective Date

The Act establishes (Section 619) a timeline for the appropriate Federal banking agencies to issue rules implementing the prohibitions on proprietary trading and investing in and sponsoring private equity funds and hedge funds, and it provides certain transition periods and extensions for banking entities to conform their activities to these requirements.

By January 21, 2011, the Council must study and make recommendations in implementing the provisions of the Volcker Rule. Within nine months following completion of the study, the appropriate Federal banking agencies, the SEC and the CFTC must consider the findings of the study and adopt implementing regulations.

The prohibitions in new BHC Act Section § 13 will take effect on the earlier of (i) 12 months after issuance of final rules, or (ii) July 21, 2012. Therefore, the effective date will be some time after July 21, 2011, but no later than July 21, 2012. The Act provides for a two year transition period with the possibility of up to three one year extensions, and it

provides for a one time five year extension for preexisting commitments to invest in certain illiquid funds.

2. Restrictions on Transactions with Affiliates

The Act makes certain changes (Section 608) to Section 23A of the Federal Reserve Act (“Section 23A”). The changes include: (1) amendments to the definitions of “affiliate” and “covered transaction” that broaden the scope of transactions subject to affiliate transaction restrictions; (2) changes to the collateral requirements for “covered transactions”; and (3) a requirement that the FRB receive input from the OCC or the FDIC before providing exemptions to affiliate transaction requirements. The amendments will be effective one year after the Transfer Date (as defined in Section I.G.1 below).

(a) Amendments to Definitions of “Affiliate” and “Covered Transaction”

The Act (Section 608(a)) amends Section 23A to:

- Expand the definition of affiliate for purposes of Section 23A to include any “investment fund” to which a member bank or an affiliate is an investment adviser;
- Provide that a repurchase agreement transaction in which a member bank purchases assets from an affiliate subject to a repurchase agreement is an extension of credit for purposes of Section 23A rather than an asset purchase covered transaction;
- Include within the definition of covered transaction (1) the acceptance of “other debt obligations” of an affiliate as collateral for a loan or extension of credit, rather than only including acceptance of “securities” of an affiliate as collateral; and (2) securities borrowing and lending transactions with an affiliate to the extent the transaction creates credit exposure of the bank or a subsidiary of the bank to the affiliate.

The Act also includes credit exposure to an affiliate arising out of derivative transactions, as defined in 12 U.S.C. § 84(b) (as amended by the Act), as a covered transaction, and it contains a provision that authorizes the FRB to issue regulations and interpretations addressing the manner in which a “netting agreement” may be taken into account in determining the amount of covered transactions between a bank and its affiliates, including the extent to which netting agreements may be taken into account in determining whether a covered transaction is fully secured for purposes of an exemption from Section 23A for extensions of credit secured by an earmarked, segregated deposit with the bank or secured by obligations of or fully guaranteed as to principal and interest by the United States government. Any interpretation with respect to a specific member bank, subsidiary or affiliate must be issued by the FRB jointly with the appropriate Federal banking agency for such member bank, subsidiary or affiliate. The term “netting agreement” is not defined.

The Act changes the current collateral requirements in Section 23A to require that the appropriate amount of collateral must be maintained “at all times,” which means that a bank that has engaged in a covered credit transaction with an affiliate will be required to obtain additional collateral if the value of the collateral securing the transaction has declined below the amount of the transaction.

(b) Exemptive and Rulemaking Authority

The Act (Section 608(a)) eliminates the authority of the FRB to unilaterally grant exemptions from Section 23A by order or regulation. However, the FRB may continue to provide exemptions from Section 23A by regulation if it finds the exemption to be in the public interest and consistent with the purposes of Section 23A, notifies the FDIC of such finding, and the FDIC does not object within 60 days based on a determination that the exemption presents an unacceptable risk to the Deposit Insurance Fund (“DIF”). The Act also authorizes the FDIC, by order, to exempt a transaction of a state nonmember bank, and the FRB, by order, to exempt a transaction of a state member bank, from the requirements of Section 23A if the FDIC and the FRB jointly find the exemption to be 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 DIF. Similarly, the OCC will have authority, by order, to exempt a transaction of a national bank from the requirements of Section 23A if the FRB and the OCC jointly find the exemption to be in the public interest and consistent with the purposes of Section 23A, the FDIC receives notice of such finding, and the FDIC does not object within 60 days based on a determination that the exemption presents an unacceptable risk to the DIF. The FRB may only provide exemptions from Section 23B after providing notice to and not receiving an objection from the FDIC.

The Act also addresses exemptive authority for savings associations. This provision amends Section 11 of the HOLA to permit the OCC, by order, to exempt “a transaction of a Federal savings association from the requirements” of Section 11 if the FRB and the OCC jointly find the exemption to be in the public interest and consistent with the purposes of Section 11 of the HOLA, notify the FDIC of such finding, and the FDIC does not object within 60 days based upon a determination that the exemption presents an unacceptable risk to the DIF. The statute grants the FRB and the FDIC similar exemptive authority with respect to state savings associations.

(c) Transactions with Financial Subsidiaries

The Act (Section 609) repeals the exception for covered transactions between a bank and a financial subsidiary from the 10% of capital and surplus limitation applicable to covered transactions between a bank and any one affiliate. The amendment also eliminates the provision that currently allows a bank to exclude retained earnings of a financial subsidiary from the amount of its investment in the financial subsidiary. The amendment takes effect one year from the Transfer Date, except that it “shall apply with respect to any covered transaction between a bank and a subsidiary of the bank . . . that is entered into on or after [July 21, 2010].”

3. Lending Limit Restrictions

(a) National Bank Lending Limits

The Act (Section 610) amends the statute governing lending limits of national banks (12 U.S.C. § 84) by including within the single borrower limitation any credit exposure of a person arising out of a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction or securities borrowing transaction between a national bank and the person. For this purpose, a “derivative transaction” includes any transaction that is a contract, agreement, swap, warrant, note or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets.

(b) Lending Limits Applicable to Derivatives Transactions

The Act (Section 611) amends Section 18 of the FDIA by prohibiting an insured state bank from engaging in a derivatives transaction (as defined in 12 U.S.C. § 84(b)) unless the law of the state in which the bank is chartered imposes lending limits that take into consideration credit exposure to derivatives transactions.

(c) Lending Limits to Insiders

The Act (Section 614) amends Section 22(h) of the Federal Reserve Act by including within the definition of extension of credit any credit exposure arising out of a derivatives transaction (as defined in 12 U.S.C. § 84(b)), repurchase agreement, reverse repurchase agreement, securities lending transaction or securities borrowing transaction between the member bank and the person. Thus, derivatives, repurchase, and securities lending and borrowing transactions between a bank and insiders and related interests of the bank and its affiliates will be subject to the requirements applicable to extensions of credit to insiders (including prior approval requirements for transactions exceeding certain amounts and the market terms requirement).

4. Asset Purchases from Insiders

The Act (Section 615) amends Section 18 of the FDIA by adding a new section that prohibits an insured depository institution from purchasing an asset from or selling an asset to an executive officer, director or principal shareholder of the insured depository institution or any related interest of such person (as such terms are defined for purposes of Section 22(h) of the Federal Reserve Act) unless: (i) the transaction is on market terms, and (ii) if the transaction represents more than 10% of the capital stock and surplus of the insured depository institution, it has been approved in advance by a majority of directors who do not have an interest in the transaction.

D. Strengthened Capital Standards

1. Leverage and Risk-Based Capital Requirements

Pursuant to Section 171 (“Section 171”) of the Act, often referred to as the Collins Amendment, the leverage and risk-based capital standards currently applicable to U.S. insured depository institutions will, going forward, serve as a floor for the capital requirements for such insured depository institutions as well as depository institution holding companies and Systemically Significant Nonbank Financial Companies.

More specifically, the appropriate Federal banking agencies are required to establish minimum leverage capital and risk-based capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies, and Systemically Significant Nonbank Financial Companies that shall not be less than the “generally applicable leverage capital requirements” and “generally applicable risk-based capital requirements,” nor quantitatively lower than the generally applicable leverage capital requirements and generally applicable risk-based capital requirements that were in effect as of July 21, 2010 for insured depository institutions.

The Act defines “generally applicable leverage capital requirements” and “generally applicable risk-based capital requirements” to mean the minimum ratios of Tier 1 capital to average total assets and the risk-based capital requirements, respectively, established by the appropriate Federal banking agencies to apply to insured depository institutions under the

prompt corrective action regulations implementing Section 38 of the FDIA, regardless of total consolidated asset size or foreign financial exposure. Such definitions include the regulatory capital components in the numerator of such capital components, the average total assets or risk-weighted assets, as applicable, in the denominator of such capital requirements, and the required ratio of the numerator to the denominator. This requirement will preclude depository institution holding companies from including trust preferred securities in Tier 1 capital.

The Act further provides (Section 171) that investments in financial subsidiaries that are required to be deducted from regulatory capital under the National Bank Act and the FDIA do not need to be deducted from regulatory capital by depository institution holding companies or Systemically Significant Nonbank Financial Companies, unless such capital deduction is required by the FRB or the primary financial regulatory agency in the case of a Systemically Significant Nonbank Financial Company.

Required regulatory capital deductions (i.e., the exclusion of applicable hybrid securities from Tier 1 capital) and certain other requirements of Section 171 are subject to various transition periods and grandfathering exemptions. For example, depository institution holding companies with total consolidated assets of less than \$15 billion as of December 31, 2009, and organizations that were mutual holding companies on May 19, 2010, are not required to make any regulatory capital deductions for debt or equity instruments issued before May 19, 2010. Any regulatory capital deductions by other depository institution holding companies or by Systemically Significant Nonbank Financial Companies for debt or equity instruments issued before May 19, 2010 will be phased in incrementally over a three year period, beginning on January 1, 2013.

With respect to debt or equity instruments issued on or after May 19, 2010, all depository institution holding companies and Systemically Significant Nonbank Financial Companies are required to make regulatory capital deductions effective as of May 19, 2010. However, debt or equity instruments issued to the U.S. Federal government or any agency thereof pursuant to the Emergency Economic Stabilization Act of 2008 before October 4, 2010 are exempt from this requirement.

For thrift holding companies, Section 171 will not be effective until July 21, 2015, subject to the phase-in period discussed above for regulatory capital deductions for debt or equity instruments issued before May 19, 2010. In addition, for U.S. bank holding company subsidiaries of foreign banking organizations that have relied on the FRB's Supervision and Regulation Letter SR-01-1, the leverage capital and risk-based capital requirements and the requirements of Section 171 for debt or equity issued before May 19, 2010 will not be effective until July 21, 2015. Small bank holding companies that are subject to the FRB's Small Bank Holding Company Policy Statement are also exempt from the requirements of Section 171.

In addition to the above requirements, Section 171 requires the Federal banking agencies, subject to the recommendations of the Council, to develop capital requirements applicable to insured depository institutions, depository institution holding companies and Systemically Significant Nonbank Financial Companies that address the risks that the activities of such institutions pose both to the institution engaging in the activity and to other public and private stakeholders – including, but not limited to, risks arising from: (i) significant volumes of activity in derivatives, securitized products, financial guarantees, securities borrowing and lending transactions, and repurchase 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.

2. Requirements for Financial Holding Company Status

The Act also provides (Section 606) that, effective as of the Transfer Date, a bank holding company must be “well capitalized” and “well managed” in order to make an election to become and maintain its qualification as a financial holding company and engage in certain financial and other activities permissible for financial holding companies under Section 4(k) of the BHC Act. In addition, the Act amends the HOLA to provide an additional exemption from its activities limitations that will enable a thrift holding company to conduct the same activities as a financial holding company if it meets the criteria to qualify as a financial holding company and conducts such activities in accordance with the same conditions and requirements applicable to financial holding companies.

3. Additional Changes to Capital Requirements

The Act further provides (Section 616) that the appropriate Federal banking agencies must seek to make capital requirements for insured depository institutions and bank and thrift holding companies countercyclical so that the amount of capital required increases in times of economic expansion and decreases in times of economic contraction, consistent with the safety and soundness of such institutions.

In addition, the appropriate Federal banking agencies must require bank holding companies and savings and loan holding companies, and any company that directly or indirectly controls an insured depository institution that is not a subsidiary of a bank holding company or savings and loan holding company, to serve as a “source of financial strength” for any depository institution subsidiaries.

As discussed above, Systemically Significant Financial Companies will be subject to heightened and broadened prudential standards, which standards may include risk-based capital requirements, liquidity requirements and a contingent capital requirement, and that the computation of capital for purposes of meeting any such capital requirements must take into account any off-balance sheet activities of such Systemically Significant Financial Company.

4. Studies and Reports on Capital

The Comptroller General of the U.S., in consultation with the applicable Federal banking agencies, is required to conduct the following studies related to capital requirements and report the results of such studies to Congress, generally by January 21, 2012.

(a) A study on the access to capital by insured depository institutions with total consolidated assets of \$5 billion or less.

(b) A study of the use of hybrid capital instruments as a component of Tier 1 capital for banking institutions and bank holding companies, considering, among other things: (1) the current use of hybrid capital instruments, such as trust preferred shares, as a component of Tier 1 capital; (2) the consequences of disqualifying trust preferred instruments, and whether it could lead to the failure or undercapitalization of existing

banking organizations; and (3) the international competitive implications of prohibiting hybrid capital instruments from Tier 1 capital.

(c) A study of capital requirements applicable to U.S. intermediate holding companies of foreign banks that are bank or thrift holding companies, considering, among other things, the principle of national treatment and equality of competitive opportunity for foreign banks in the U.S., and the extent to which foreign banks are subject on a consolidated basis to home country capital standards comparable to U.S. capital standards.

E. Regulation of Non-Bank Holding Companies

The Act includes several provisions that potentially affect any company that directly or indirectly controls one or more insured depository institutions and that is not a “bank” within the meaning of the BHC Act or that seeks to acquire control of a non-bank institution, such as a savings association, a limited purpose trust company, a credit card bank or an industrial bank or industrial loan company.

1. Ownership of Trust Banks, Credit Card Banks and Industrial Banks

The Act retains the current exclusions in the BHC Act pursuant to which a company that controls an industrial bank, a credit card bank and/or a limited purpose trust company will not be treated as a bank holding company, provided the company is not otherwise subject to the BHC Act. However, the Act establishes (Section 603) a three year moratorium on approval of deposit insurance applications and change in control notifications for industrial banks, credit card banks, and trust banks that would be controlled by commercial firms. For this purpose, the Act defines a “commercial firm” as a company whose annual gross revenues derived from activities that are financial in nature (as defined in Section 4(k) of the BHC Act) and, if applicable, from the ownership and control of one or more insured depository institutions, represents less than 15% of the consolidated annual gross revenues of the company. Also, for purposes of the moratorium, a “credit card bank” means an institution described in Section 2(c)(2)(F) of the BHC Act, and a “trust bank” means an institution described in Section 2(c)(2)(D) of the BHC Act.

The requirement to disapprove a change in control notification does not apply to a change in control of an industrial bank, credit card bank or trust bank that (1) is in danger of default; (2) results from the merger or whole acquisition of a commercial firm that directly or indirectly controls the industrial bank, credit card bank or trust bank in a bona fide merger with or acquisition by another commercial firm, as determined by the appropriate Federal banking agency; or (3) results from an acquisition of voting shares of a publicly traded company that controls an industrial bank, credit card bank, or trust bank if, after the acquisition the acquiring shareholder (or group of shareholders acting in concert) holds less than 25% of any class of voting shares of the company. In all cases, the transaction must be approved under any applicable Federal or state law. In addition, a state-chartered limited purpose trust company that is not FDIC-insured is not subject to the federal Change in Bank Control Act and is not affected by these provisions.

The Act requires (Section 603(b)) the Comptroller General of the U.S. to conduct a study to determine whether it is necessary, in order to strengthen the safety and soundness of institutions or the stability of the financial system, to eliminate the BHC Act exceptions for bankers' banks, certain grandfathered trust companies and mutual savings banks, trust companies, credit card banks, industrial banks, and savings associations.

2. Savings and Loan Holding Companies

Unlike the House Bill, the Act retains the exception from the definition of “bank” in the BHC Act for savings associations. Thus, a company that controls a federal or state savings association and that is not otherwise a bank holding company for purposes of the BHC Act would remain a savings and loan holding company and would not be subject to regulation by the FRB under the BHC Act. However, as addressed below, the Act transfers to the FRB the current functions and responsibilities of the OTS with respect to supervision and examination of savings and loan holding companies under Section 10 of the HOLA, and it transfers to the OCC and the FDIC responsibility for regulating federal and state savings associations, respectively. As a result, the Act eliminates one of the historical advantages of the savings and loan holding company structure—having the OTS as the single Federal bank regulator for the consolidated organization.

The Act also preserves the so-called “grandfathered” rights set forth at Section 10(c)(9) of the HOLA for any company that was a savings and loan holding company on May 4, 1999 or that became a savings and loan holding company pursuant to an application pending before the OTS on or before that date, provided that such company meets and continues to meet the requirements of Section 10(c)(3) of the HOLA related to unitary savings and loan holding companies and continues to control not fewer than one savings association that it controlled on May 4, 1999 or that it acquired pursuant to an application pending before the OTS on or before that date. Such companies may continue to engage in any activities without limitation under the HOLA. However, the Act adds (Section 626) a new Section 10A to the HOLA that authorizes the FRB to require a grandfathered unitary savings and loan holding company engaged in activities other than financial activities to establish and conduct all or a portion of such financial activities through an intermediate holding company, which shall be treated as a savings and loan holding company. The FRB must require a grandfathered unitary savings and loan holding company to establish an intermediate holding company through which it must conduct financial activities if the FRB determines that establishment of an intermediate holding company is necessary to appropriately supervise activities that are determined to be financial activities or to ensure that supervision of such activities by the FRB does not extend to the activities of the company that are not financial activities. The FRB is required to adopt regulations implementing Section 626 not later than 90 days (or such longer period of time as the FRB may deem appropriate) after the Transfer Date.

Section 604(i) of the Act makes an important change to the definition of “savings and loan holding company” in Section 10(a)(1)(D) of the HOLA to exclude from the definition of savings and loan holding company “a company that controls a savings association that functions solely in a trust or fiduciary capacity as described in section 2(c)(2)(D) of the [BHC Act]” as well as a “company described in subsection (c)(9)(C) solely by virtue of such company’s control of an intermediate holding company established pursuant to section 10A” of the HOLA. This change means that a company that controls a limited purpose savings association that functions solely in a trust or fiduciary capacity and meets other requirements described at Section 2(c)(2)(D) of the BHC Act and does not control any other savings association will not be treated as a savings and loan holding company. Similarly, a grandfathered savings and loan holding company required by the FRB to establish an intermediate holding company under new Section 10A of the HOLA will not itself be treated as a savings and loan holding company (though Section 10A makes it clear that the intermediate holding company will be treated as a savings and loan holding company). Thus, these types of companies will not be subject to any limitations on activities or

investments under the HOLA, and they will not be subject to the requirements of the Collins Amendment (described above) with respect to minimum capital requirements. However, the Act mandates that a grandfathered unitary savings and loan holding company that directly or indirectly controls an intermediate holding company established under Section 10A must serve as a source of financial strength to the intermediate holding company, and another provision of the Act directs the appropriate Federal banking agencies to require any company that directly or indirectly controls an insured depository institution that is not a subsidiary of a bank holding company or savings and loan holding company to serve as a source of financial strength to the institution.

F. Supervision of Bank Holding Companies and Thrift Holding Companies

The Act expands (Section 604) the FRB's authority to require reports from, examine and regulate all subsidiaries of a bank holding company or thrift holding company, including those that are functionally regulated. The FRB must notify and consult with the appropriate Federal or state banking agency, the SEC, or the CFTC, as applicable, before examining a functionally regulated subsidiary or a depository institution subsidiary. This examination authority is made subject to the Bureau's authority with respect to Federal consumer financial law. With respect to requiring reports, the FRB is directed to use, to the fullest extent possible, reports and other supervisory information already provided to other regulatory agencies, as well as externally audited financial statements and any other information otherwise available.

To assure consistency in the oversight of holding company subsidiaries, the Act directs (Section 605) the FRB to examine the activities of non-depository institution subsidiaries of a bank or thrift holding company (other than subsidiaries that are functionally regulated or depository institution subsidiaries) in the same manner as if the activities were conducted at the lead depository institution of the bank or thrift holding company. This examination authority is made subject to the Bureau's authority with respect to Federal consumer financial law. The FRB is required to consult and coordinate with any applicable state regulators, and may conduct examinations in a joint or alternating manner if the FRB determines that an examination conducted by the state carries out the purposes of Section 605. In addition, the appropriate Federal banking agency for the lead insured depository institution may exercise back-up examination authority if the FRB does not conduct the required examinations, subject to certain conditions.

G. Elimination of the OTS; Status of Thrift Charter (Title III)

1. Elimination of OTS

Pursuant to Title III, Subtitles A and B of the Act, all functions of the OTS will be transferred (the "Transfer") to and divided among the OCC, the FRB, and the FDIC on July 21, 2011 unless extended as noted below. The Transfer will take place pursuant to a joint plan to be submitted to Congress by the OTS, the OCC, the FRB and the FDIC. By January 21, 2011, the date of the Transfer (the "Transfer Date") may be extended by the Treasury (in consultation with the OTS, the OCC, the FRB, and the FDIC) for up to an additional six months if the Treasury Secretary submits a report to Congress explaining, among other things, why more time is needed to effect the Transfer. The OTS will be abolished 90 days after the Transfer Date.

After the Transfer, the FRB will assume (i) supervision of thrift holding companies and any non-depository institution subsidiary thereof, (ii) rulemaking authority relating to thrift

holding companies, and (iii) rulemaking authority under Section 11 of the Home Owners' Loan Act pertaining to affiliate transactions and extensions of credit to executive officers, directors and shareholders. The OCC will assume (i) supervision of federal thrifts and (ii) rulemaking authority over all thrifts, both federal and state. The FDIC will assume supervision of state-chartered thrifts. We note that the Act does not change the FRB's role as primary Federal regulator of state member banks.

All regulatory issuances of the OTS, including but not limited to orders, resolutions, determinations, agreement, regulations, and interpretive rules, will remain in effect after the Transfer and will be enforceable by or against the FRB, the OCC, or the FDIC, as appropriate, except to the extent modified or terminated in accordance with law. In addition, no later than the Transfer Date, each of the FRB, the OCC and the FDIC must identify and publish a list of the regulations of the OTS for which it will have the primary responsibility of enforcing.

2. Status of Thrift Charter

The Act maintains the federal thrift charter, but reduces the attractiveness of the charter and penalizes a thrift that fails to become or remain a "qualified thrift lender" as defined in the HOLA. The Act amends (Section 624) Section 10(m) of the HOLA to provide that a savings association that fails to become or remain a qualified thrift lender shall immediately become subject to restrictions on branching, activities and dividends and eliminates the option currently provided by Section 10(m) for such a savings association to convert to a bank. However, as currently required, if a savings association fails to re-qualify as a qualified thrift lender within one year of failing to meet qualified thrift lender requirements, its holding company must register as and become a bank holding company. Section 624 also codifies existing OTS policy that requires every savings association to become and remain a qualified thrift lender by adding a provision to the HOLA that states that a savings association that fails to become and remain a qualified thrift lender shall be deemed to have violated Section 5 of the HOLA.

Section 625 adds a requirement to the HOLA that every savings association that is a subsidiary of a mutual holding company must give the appropriate Federal banking agency and the FRB not less than 30 days prior notice before the date of a proposed declaration by its board of directors of a dividend. Section 10(f) of the HOLA already imposes a similar requirement on any savings association that is a subsidiary of a savings and loan holding company. Section 625 also permits a mutual holding company to waive the right to receive dividends from a subsidiary savings association only if no insider of the mutual holding company, associate of an insider, or tax qualified or non tax qualified employee stock benefit plan of the mutual holding company holds any share of the class of stock to which the waiver would apply, or the mutual holding company has given notice to the FRB not less than 30 days before the date of the proposed dividend payment and the FRB does not object to such waiver.

H. FRB, OCC and FDIC Assessment Powers Under Title III

The Act (Section 318) gives the FRB the power to collect assessments from bank holding companies and thrift holding companies that have consolidated assets of \$50 billion or more and from Systemically Significant Nonbank Financial Companies, in an amount equal to the total cost of supervising and regulating those entities. The Act also allows the OCC to collect assessments from any entity for which it is the primary federal regulator, and

authorizes the FDIC to charge each depository institution for the cost of conducting any examination, regular or special, of that bank.

I. Changes to Federal Deposit Insurance (Title III, Subtitle C)

1. Permanent Increase in Deposit and Share Insurance

The Act permanently increases the maximum amount of FDIC insurance that will be provided to each depositor at any depository institution or credit union to \$250,000, retroactively effective as of January 1, 2008. The Act also extends the Transaction Account Guarantee Program for two years from December 31, 2010 for all insured depository institutions.

2. Change in Deposit Insurance Assessment Calculation

The Act redefines the FDIC's deposit insurance assessment base with respect to an insured depository institution to be equal to (i) the average consolidated total assets of the depository institution during the assessment period minus (ii) the average tangible equity of the insured depository institution during the assessment period or, in the case of a banker's bank or custodial bank, an amount that the FDIC determines is necessary consistent with the provisions of the FDIA. The Act also increases the minimum reserve ratio of the DIF to 1.35 percent of estimated insured deposits, which ratio must be attained by September 30, 2020. The Act removes the ceiling on the minimum reserve ratio for the DIF. In levying assessments to reach the newly heightened reserve ratio, the FDIC 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.

J. FRB Emergency Lending and FDIC Emergency Financial Stabilization Authorities (Title XI)

1. FRB Emergency Lending Authority

Title XI of the Act significantly limits the FRB's emergency lending powers under Section 13(3) of the Federal Reserve Act ("Section 13(3)"). The Act permits the FRB to exercise its emergency lending authority only to provide assistance to participants in a program or facility with "broad-based eligibility," rather than, as previously permitted, to a single individual, partnership or corporation. The Treasury Secretary must approve any emergency lending program or facility.

The FRB, in consultation with the Treasury Secretary, must adopt regulations establishing policies and procedures designed to ensure that: (1) emergency lending programs or facilities are used to provide liquidity to the financial system and not to aid a failing financial institution; (2) the security provided by recipients of emergency loans is sufficient to protect taxpayers from losses; and (3) any emergency lending program is terminated in a timely and orderly fashion. The policies and procedures must require the appropriate Federal Reserve Bank, in determining whether a loan is satisfactorily secured, to assign a lendable value to the collateral.

The FRB is required to establish procedures to prohibit emergency lending to borrowers that are insolvent. If an entity that receives emergency assistance becomes subject to FDIC resolution authority, the Reserve Bank which made the loan will have a claim equal to the amount of the net realized loss with the same priority as an obligation to the Treasury Secretary.

Within seven days of authorizing an emergency facility, the FRB must submit a report to Congress describing the justification for the facility, the identity of the recipients, and the date, amount, form, and material terms of the assistance. The Act states that financial stability is a function of the FRB.

Under the Act, the GAO will: (i) conduct a one-time review of the FRB's emergency funding under Section 13(3) since 2007; (ii) audit the Federal Reserve System by July 21, 2011; and (iii) have the authority to audit financial assistance provided by the FRB under Section 13(3).

2. FDIC Emergency Financial Stabilization

Title XI of the Act also limits the FDIC's emergency financial stabilization authority. When requested by the Treasury Secretary, the FDIC and the FRB must determine whether there is a "liquidity event" that warrants the establishment of an FDIC guarantee program. A "liquidity event" is (A) an exceptional and broad reduction in the general ability of financial market participants (i) to sell financial assets without an unusual or significant discount, or (ii) to borrow using financial assets as collateral without an unusual and significant increase in margin; or (B) an unusual or significant reduction in the ability of financial market participants to obtain unsecured credit.

If 2/3 of the members of the FDIC Board and 2/3 of the FRB Governors determine that a "liquidity event" has occurred, the FDIC must create a widely available program to guarantee (other than by providing equity) the obligations of solvent insured depository institutions or depository institution holding companies (including their affiliates) during times of severe economic distress. Moreover, following approval of a joint resolution by Congress, the FDIC may provide guarantees up to a maximum amount established by the Treasury Secretary in consultation with the President. The FDIC will charge fees and other assessments to participants in any guarantee program as necessary to offset project losses and administrative expenses. The FDIC may borrow from the Treasury in connection with a guarantee program, but may not borrow funds from the DIF. If an insured depository institution or depository institution holding company participant in a debt guarantee program defaults on its obligations, the FDIC will either appoint itself receiver (in the case of a depository institution) or resolve the company under Title II of the Act (as discussed above) or file a petition for bankruptcy on behalf of the company (in the case of a depository institution holding company).

K. Changes to Acquisition and De Novo Branching Requirements and Restrictions on Charter Conversions

The Act amends the standards for approving interstate bank merger and acquisition transactions under the BHC Act and the FDIA (Section 607). As of the Transfer Date, the appropriate federal banking agency may approve an application for such a transaction only if the resulting bank or bank holding company will be well capitalized and well managed. The Act expands (Section 623) the current deposit cap to include deposits held by savings associations, which will preclude an interstate merger or acquisition transaction (Section 623) by an insured depository institution or its holding company if the resulting institution or holding company would control 10% or more of the total amount of deposits of insured depository institutions in the United States. The Act adds a similar deposit cap limitation to Section 10 of the HOLA with respect to interstate acquisitions by savings and loan holding companies. Acquisitions of insured depository institutions in default or in danger of default are exempt from these limitations. The Act establishes (Section 622) a concentration limit

that prohibits financial companies (including insured depository institutions and their holding companies and Systemically Significant Nonbank Financial Companies) from acquiring or merging with another company if the resulting financial company's total consolidated liabilities would exceed 10% of the aggregate consolidated liabilities of all financial companies as of the end of the prior calendar year. Acquisitions of insured depository institutions in default or in danger of default are also exempt from this concentration limit. The Council must complete a study of the concentration limit by January 21, 2011, and the FRB must, by April 21, 2011, prescribe final regulations implementing the concentration limit, which regulations must take into account the results of the Council's study. Effective as of the Transfer Date, when approving a proposed acquisition or merger by a bank or bank holding company, the federal banking agencies must consider the impact of such transaction on the stability of the U.S. financial system (Section 604(d)-(f)).

The Act permits (Section 613) de novo interstate branching by national banks and state-chartered insured depository institutions. The Act (Section 612) generally prohibits the conversion of (i) a national bank to a state-chartered depository institution, (ii) a state-chartered depository institution to a national bank or federal thrift, and (iii) a federal thrift to a state-chartered depository institution, during the period any such institution is subject to a cease and desist order, or other formal enforcement order or memorandum of understanding with respect to a "significant supervisory matter."

L. Interest-Bearing Transaction Accounts

Effective as of July 22, 2011, the Act (Section 627) eliminates the prohibition on the payment of interest on demand deposits, allowing businesses to hold interest-bearing checking accounts.

M. Asset-Backed Securities

1. Credit Risk Retention

The Act requires (Section 941) the Federal banking agencies, the SEC and, with respect to residential mortgage-backed securities, the Secretary of Housing and Urban Development and the Federal Housing Finance Agency, to jointly issue regulations requiring any "securitizer" (defined as the issuer of an asset-backed security or a person who organizes and initiates an asset-backed security transaction by selling or transferring assets to the issuer) to retain an economic interest in the credit risk of the security's underlying assets. These regulations must be adopted by April 17, 2011, with the effective date of those regulations dealing with residential mortgage-backed securities being one year after the publication of such final rules and the effective date of those regulations dealing with all other classes of asset-backed securities being two years after the publication of such final rules.

The Act requires the applicable regulators to establish separate rules, including separate underwriting standards, for different classes of assets, including residential mortgages, commercial mortgages, commercial loans and auto loans. In general, the regulations must: (i) require securitizers to retain at a default level not less than 5% of the risk for any particular securitized asset; (ii) prohibit a securitizer from hedging or otherwise transferring such risk; and (iii) specify the permitted forms and minimum duration of the risk retention. However, as discussed in more detail below, "qualified residential mortgages" are exempt from this risk retention requirement, and the Act further provides that the risk retention

requirement shall be less than 5% if the originator of an asset meets certain underwriting standards to be prescribed by the regulators. The regulators may also reduce the required risk retention for a securitizer to reflect risk required to be retained by an originator.

As indicated above, the regulations will not require a securitizer to retain any credit risk with respect to an asset-backed security if all of the assets that collateralize such asset-backed security are “qualified residential mortgages.” The term “qualified residential mortgages” is to be defined by the applicable regulators, taking into account underwriting and product features indicating a lower risk of default, but such definition may not be broader than the definition of “qualified mortgage” in Section 129C(c)(2) of the Truth in Lending Act (“TILA”). The Act further provides, though, that an asset-backed security that is collateralized by tranches of other asset-backed securities may not be exempt from the risk retention requirement described above.

The Act also directs the regulators to consider imposing a different set of requirements with respect to commercial mortgage-backed securities by specifying separate permissible types, forms and amounts of risk retention that would qualify, which may include: (1) retention of a different minimum percentage or amount of risk; (2) retention of the first-loss position by a third-party purchaser that satisfies certain criteria; (3) a determination by the regulators of the adequacy of the underwriting standards and controls for an asset; or (4) the provision of adequate representations and warranties.

In addition, the regulations must provide total or partial exemptions for, among other things, securitizations of assets issued or guaranteed by the Federal government or one of its agencies (not including Fannie Mae or Freddie Mac) or any asset-backed security issued or guaranteed by any state or by a political subdivision of any state or territory. The Act also provides that the risk retention requirements described above shall not be applicable to (a) any loans or financial assets issued, guaranteed or purchased by any institution subject to supervision by the Farm Credit Administration or (b) any residential, multi-family or healthcare facility mortgage loan asset, or securitization that is based on such an asset, which is insured or guaranteed by the Federal government or an agency thereof (not including Fannie Mae or Freddie Mac). The regulators are also permitted to provide any other exemptions they deem appropriate in the public interest and for the protection of investors.

2. Additional Securities Law Changes

The Act amends (Section 942) Section 15(d) of the 1934 Act to provide that periodic reporting is not automatically suspended for an asset-backed security issuer when there are fewer than 300 security holders, although the SEC may adopt rules providing for such a suspension of periodic reporting on more limited terms. The Act also requires the SEC to adopt regulations requiring asset-backed securities issuers to disclose, for each tranche or class of security, information regarding the assets backing such securities. In adopting these regulations, the SEC is required to: (1) set standards for the format of the data provided in order to facilitate comparison of such data across securities in similar types of asset classes; and (2) require issuers to disclose asset-level or loan-level data, if such data is necessary for investors to independently perform due diligence.

In addition, the SEC must develop regulations on the use of representations and warranties in asset-backed securities transactions that require: (a) ratings agencies to include in any credit rating report a description of the representations, warranties and enforcement

mechanisms attendant to each security and how they differ from those found in similar issued securities; and (b) securitizers to disclose fulfilled and unfulfilled repurchase requests across all trusts aggregated by the securitizer.

Furthermore, the SEC must issue rules requiring any issuer of an asset-backed security to perform a review of the assets underlying the securitization and to disclose the nature of such review.

3. Studies

The Act includes provisions requiring two studies related to risk retention with respect to asset-backed securities. The FRB must conduct a study, in coordination with the OCC, the OTS, the FDIC and the SEC, of the impact of the new credit risk retention requirements and Financial Accounting Standards 166 and 167 on each class of asset-backed securities. In addition, the Chairman of the Council is required to conduct a study on the macroeconomic effects of the risk retention requirements.

4. Conflicts of Interest

The Act amends (Section 621) the 1933 Act to prohibit an underwriter, placement agent, initial purchaser, or sponsor (or any affiliate or subsidiary of any such entity) of an asset-backed security from engaging in any transaction that would involve or result in any “material conflict of interest” with respect to any investor for one year after the date of the first closing. This prohibition is subject to certain exceptions, including with respect to certain risk-mitigating hedging activities. The SEC is required to issue rules implementing such prohibition.

N. Swaps “Push-out” Rule

The Act permits insured depository institutions to continue to trade certain derivatives. Derivatives activities permitted for such institutions include the use of derivatives for hedging and other similar risk mitigating activities directly related to such depository institution’s activities and acting as swaps entities for swaps or security-based swaps involving rates or reference assets that are permissible for investment by a national bank under the National Bank Act and, in the case of credit default swaps and security-based swaps, are cleared through a registered derivatives clearing organization or clearing agency. Generally, permissible reference assets include, among others, investment grade debt securities, gold and silver, foreign exchange and interest rates, but exclude commodities and equity securities. Insured depository institutions will, however, be required to spin off to separately capitalized affiliates to conduct all derivatives trading not expressly permitted by the Act, including commodities derivatives, equity derivatives and uncleared credit default swaps. Each insured depository institution will have a transition period determined by its prudential regulator after consultation with the SEC (for security-based swaps) and the CFTC (for swaps) of up to 24 months following the CFTC’s and SEC’s rule-making under Title VII of the Act in which to spin off a “swaps entity” and otherwise cease any prohibited activities. The Act requires such rulemaking to be complete by July 17, 2013. (Section 716.)

II. Consumer Financial Protection Reform

A. Formation and Powers of Bureau of Consumer Financial Protection

Title X of the Act establishes the Bureau as an independent bureau within the Federal Reserve System to regulate consumer financial products or services under the federal consumer financial laws. The term “Federal consumer financial law” is defined to include Title X; the enumerated consumer laws; the laws governing the consumer financial protection functions of the federal banking agencies, the Department of Housing and Urban Development (HUD) and the Federal Trade Commission (FTC), except with respect to the FTC’s authority under the Federal Trade Commission Act; and any rule or order prescribed by the Bureau under any of the foregoing.

The “enumerated consumer laws” include the Alternative Mortgage Transaction Parity Act, the Consumer Leasing Act, the Electronic Fund Transfer Act (EFTA) (except the Durbin interchange amendment), the Equal Credit Opportunity Act, the Fair Credit Billing Act, most of the Fair Credit Reporting Act (FCRA), the Homeowners Protection Act, the Fair Debt Collection Practices Act, portions of the FDIA, the privacy provisions of the Gramm-Leach-Bliley Act, the Home Mortgage Disclosure Act, the Home Ownership and Equity Protection Act, the Real Estate Settlement Procedures Act, the S.A.F.E. Mortgage Licensing Act, the Truth in Lending Act, the Truth in Savings Act, section 626 of the Omnibus Appropriations Act, 2009 and the Interstate Land Sales Full Disclosure Act.

The term “financial product or service” includes, subject to certain exceptions, credit extension and loan servicing; real property leases; real estate settlement services and appraisals; deposit taking; funds exchange and transmittal; consumer fund custodial services; stored value cards; check cashing, collection and guaranty services; payment processing services; financial advisory services; consumer report-related services; debt collection; and other products and services that may be defined by the Bureau. The term does not include the business of insurance or electronic conduit services. “Consumer financial products or services” include financial products or services offered or provided to consumers for personal, family or household purposes or, in the case of credit extension or loan servicing, real estate settlement services or appraisals, consumer report-related services or debt collection, a product or service delivered, offered or provided in connection with a consumer financial product or service.

The Bureau will have a director (Director) to be appointed by the President and confirmed by the Senate; the Director will have a five-year term. The Bureau will have ombudsmen, as well as several units and offices. The Director will be required to make periodic appearances before Congress and to submit periodic reports to Congress.

The Act also establishes a Consumer Advisory Board to advise the Bureau, the members of which the Director will appoint. At least six members must be appointed upon the recommendation of the regional Federal Reserve Bank Presidents, on a rotating basis.

The Treasury Secretary, in consultation with the heads of the federal banking agencies, will designate a date for the transfer of functions to the Bureau (the “Designated Transfer Date”). This date must be between January 17, 2011 and July 21, 2011, unless the Treasury Secretary determines that the orderly implementation of Title X is not feasible within 12 months. In no case may the Designated Transfer Date be later than January 21, 2012.

On the Designated Transfer Date, consumer financial protection functions will be transferred from the federal banking agencies and, for certain purposes, from the FTC. The Bureau and the federal banking agencies and HUD will jointly determine the employees of such agencies to transfer to the Bureau. These identified employees will be transferred to the Bureau not later than 90 days after the Designated Transfer Date.

The Act gives the Bureau the authority to implement the federal consumer financial laws through rules, orders, guidance, interpretations, statements of policy, examinations and enforcement actions. Among the Bureau's primary functions are supervision and enforcement and issuance of rules, orders and guidance implementing the federal consumer financial laws. The Bureau will have exclusive rulemaking authority to implement the provisions with respect to the federal consumer financial laws. A civil penalty fund will be established for payments to the victims of activities for which civil penalties have been imposed. The Bureau will have the authority to impose registration requirements on persons subject to its jurisdiction, other than insured depository institutions and insured credit unions and their related persons. After conducting a study on the matter, the Bureau may condition or limit the use of mandatory pre-dispute arbitration provisions. The Bureau is further permitted to prescribe rules and take enforcement actions with respect to covered persons and service providers to prevent unfair, deceptive and abusive practices in connection with a consumer financial product or service.

On the petition of a member agency, the Council may set aside a final regulation prescribed by the Bureau, or any provision thereof, if the Council decides that the regulation will put the safety and soundness of the U.S. banking system or the stability of the U.S. financial system at risk. The Chairperson of the Council also may stay the effectiveness of a regulation for the purpose of allowing appropriate consideration of the petition by the Council upon the request of any member agency. The Council's decision to set aside a regulation or provision thereof would render that regulation or provision unenforceable.

Generally, and subject to certain exceptions, the Bureau will not have authority with respect to merchants, retailers and other sellers of nonfinancial goods or services; licensed or registered real estate agents and brokers; agents and brokers for buyers or sellers of manufactured or modular homes; accountants and tax preparers; attorneys; persons regulated by a state insurance regulator; employee benefit and compensation plans and qualified tuition programs; persons regulated by a state securities commission; persons regulated by the SEC or the CFTC; persons regulated by the Farm Credit Administration; activities related to the solicitation or making of voluntary contributions to a tax-exempt organization; or auto dealers. The Bureau also may not define engaging in the business of insurance as a financial product or service. The Bureau will not have the authority to establish usury limits unless explicitly authorized by law.

1. Supervision – Banks

With respect to consumer financial laws, products and services, the Bureau will have exclusive authority to require reports of and examine insured depository institutions and any affiliates thereof and insured credit unions and any affiliates thereof, in each case if the institution has more than \$10 billion in total assets. The Bureau will have primary authority to enforce federal consumer financial law with respect to such persons. Supervision and examination of smaller banks and credit unions will remain with their current regulators (except smaller thrifts, which will be regulated by the OCC). Federal agencies that enforce federal consumer financial laws, other than the FTC, may recommend that the Bureau

initiate an enforcement proceeding. If the Bureau does not act on such recommendation within 120 days, the recommending agency may initiate an enforcement proceeding. Service providers to these larger institutions also will be subject to the Bureau's enforcement authority to the extent permitted for a federal banking agency under the Bank Service Company Act. The Bureau must coordinate examinations with prudential regulators and state bank supervisors.

The Director may require reports from insured depository institutions and credit unions with total assets of \$10 billion or less. The Bureau may, but is not required to, participate in examinations performed by the prudential regulator for such institutions. For these depository institutions and credit unions, the prudential regulator will retain exclusive enforcement authority with respect to federal consumer financial laws. When the Bureau believes that such an institution has materially violated a federal consumer financial law, it must notify the prudential regulator and recommend appropriate action. A service provider to a "substantial number" of such smaller institutions will be subject to the Bureau's enforcement authority to the extent permitted for a federal banking agency under the Bank Service Company Act.

2. Preemption/Visitorial Powers

The Act provides that a state law is not inconsistent with the provisions of Title X if such law offers greater consumer protection. The Bureau may make a determination that a state law is inconsistent with Title X on its own motion or in response to a non-frivolous petition by any interested person. The Bureau must initiate a rulemaking whenever a majority of the states has enacted a resolution in support of the establishment or modification of a consumer protection regulation by the Bureau. Title X is not meant to alter or affect the application of a regulation, order, guidance or interpretation of the OCC or OTS regarding the applicability of state law to a preexisting contract.

A state attorney general may bring a civil action against a national bank or federal savings association to enforce regulations prescribed under Title X, with prior notice to the Bureau. A state regulator may bring a civil action to enforce the provisions of Title X or the regulations promulgated thereunder against an entity that is state-chartered, incorporated, licensed or otherwise authorized to do business under state law, with prior notice to the Bureau. The Act further states that the ability of the OCC to bring an enforcement action does not preclude a private party from enforcing rights granted under federal or state law.

The Act sets forth a preemption standard pursuant to which a state consumer financial law is preempted only if it either has a discriminatory effect on national banks, "prevents or significantly interferes with the exercise by the national bank of its powers," or is preempted by a provision of federal law. A determination that a state law prevents or significantly interferes with a national bank's powers may be made by a court, or on a case-by-case basis by the Comptroller of the Currency (Comptroller) supported by "substantial evidence." The Comptroller may not delegate such determination. "Case-by-case basis" refers to a determination regarding a particular state law or the law of another state with "substantively equivalent terms," as determined by the OCC in consultation with the Bureau. These preemption standards apply to state laws affecting federal savings banks as well.

The Act also codifies the deference standard set forth in the U.S. Supreme Court's decision in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944), pursuant to which the validity of the

agency's determination must be assessed based on the thoroughness of the agency's consideration, the validity of the agency's reasoning, the consistency with the agency's other valid determinations and other persuasive and relevant factors.

The Act requires the Comptroller to review each preemption determination, through notice and public comment, at least every five years and to submit a report to Congress regarding such review. The Comptroller also must publish a list of the OCC's preemption determinations in effect. Pursuant to the Act, contrary to the U.S. Supreme Court's decision in *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1 (2007), federal preemption will not apply to subsidiaries and affiliates of national banks that are not themselves national banks. The Act is not meant to affect a national bank's ability to charge interest in accordance with the "most favored lender" test.

3. Interchange Fees

The Act requires interchange fees that debit card issuers charge or receive with respect to electronic debit transactions to be "reasonable and proportional to the cost incurred by the issuer with respect to the transaction." Not later than 9 months after the Designated Transfer Date, the FRB must prescribe regulations to establish standards for assessing whether interchange fees in electronic debit transactions are reasonable and proportional and, in doing so, the FRB must consider the functional similarity between electronic debit transactions and checking transactions that are required to clear at par. The FRB may solicit information from issuers and payment card networks necessary to prescribe such regulations and must disclose the aggregate information collected at least biannually as the FRB "considers appropriate and in the public interest." The FRB also must prescribe regulations regarding network fees and prohibiting exclusive network agreements or requirements and routing restrictions. The FRB may allow a debit card issuer to adjust an interchange fee if such adjustment is reasonably necessary based on the issuer's costs in preventing fraud and the issuer complies with the fraud-related standards established by the FRB.

The Act prohibits a payment card network from inhibiting the ability of any person to provide certain discounts or in-kind incentives by cash, check, debit card or credit card and from penalizing any person for providing a lawful discount. Payment card networks are also prohibited from inhibiting the ability (i) of any person to set a minimum limit for credit card payments that does not differentiate between issuers or between payment card networks and that does not exceed \$10, and (ii) of any federal agency or institution of higher education to set a maximum limit for the acceptance of credit cards that does not differentiate between issuers or between payment card networks.

Small issuers, defined as issuers that, together with their affiliates, have assets of less than \$10 billion, will be exempt from the interchange fee regulations. For purposes of this provision, the term "issuer" is limited to the entity holding the asset account that is debited through an electronic debit transaction. These provisions also do not apply to interchange fees charged or received with respect to debit or general-use cards issued pursuant to a federal, state or local government-administered payment program, or to prepaid reloadable plastic cards, payment codes or devices redeemable at multiple, unaffiliated merchants or service providers or automated teller machines (ATMs) (not including gift cards or gift certificates). After the end of the one-year period following the Designated Transfer Date, the interchange fee regulations will apply to interchange fees with respect to such debit or general-use cards issued pursuant to a federal, state or local government-administered

payment program and to prepaid reloadable plastic cards if overdraft fees or fees for the first withdrawal per month from an ATM not in the issuer's designated ATM network may be charged.

Beginning one year after the Designated Transfer Date, the FRB must report annually to Congress on the prevalence of the use of general-use prepaid cards in government-administered payment programs and the interchange and cardholder fees charged with respect to the use of such cards.

4. Credit Scores

The Act amends the FCRA to require a user of a consumer report to provide a consumer with a numerical credit score in adverse action notices and risk-based pricing notices. This provision will be effective on the Designated Transfer Date.

5. Remittance Transfers

Title X also amends the EFTA to regulate remittances, defined as electronic transfers of funds requested by a sender to a designated recipient that is initiated by a remittance transfer provider, whether or not the sender holds an account with the remittance transfer provider. The Act requires providers to give advance disclosures regarding applicable exchange rates and fees and specified disclosures on receipts. Disclosures vary for storefront remittance providers and internet providers, as well as for transactions conducted entirely by telephone. The Act imposes error resolution procedures and appropriate remedies in the case of errors.

6. Enforcement and Remedies

The Bureau has broad enforcement authority regarding federal consumer financial law, including primary enforcement authority over larger institutions. The Bureau's enforcement authority includes the right to impose penalties and restitution and to bring a civil action in its own name to impose a civil penalty or seek equitable relief. The Act also provides protection for whistleblowers and employees who report violations and cooperate with authorities.

B. Supervision of Nondepository Institutions

The Act grants supervisory authority over several types of large nondepository institutions to the Bureau. The provisions of nondepository supervision apply to "covered persons," defined as "(A) any person that engages in offering or providing a consumer financial product or service; and (B) any affiliate of a person described in subparagraph (A) if such affiliate acts as a service provider to such person." The Bureau's grant of authority includes nondepository covered persons that (1) offer or provide origination, brokerage or servicing for residential mortgage loans, (2) certain large entities for other consumer financial products or services to be defined by a future rule, (3) engage or have engaged in conduct that, in the view of the Bureau, poses risk with regard to the offering or provision of consumer financial products or services, (4) offer or provide private education loans, or (5) offer or provide payday loans to consumers. The Bureau rule to determine the scope of coverage for nondepository institutions, drafted in consultation with the FTC, must be issued as an initial rule within one year after the Designated Transfer Date.

For nondepository covered persons, the Bureau must require reports and is given examination authority to (i) assess compliance with consumer financial protection laws, (ii)

obtain information about the activities and compliance systems or procedures of the nondepository covered person, and (iii) detect and assess risk to consumers and markets of consumer financial products and services. The Bureau is required to issue rules on recordkeeping and other requirements and to coordinate supervision of nondepository covered persons with other state and federal regulators.

In the enforcement of federal consumer financial requirements overseen by the Bureau, and the Bureau's rulemaking and examination of nondepository covered persons, the Act gives the Bureau exclusive authority to enforce the requirements, issue rules and conduct examinations, even if other provisions of law grant some enforcement, rulemaking or examination authority to another agency. The Act requires the Bureau and the FTC to negotiate an agreement for coordinating on enforcement actions and limits the ability of each agency to initiate a civil action for a violation of federal when the other agency has already filed suit based on the same matter.

C. Mortgage Loan Regulatory Provisions (Title XIV)

Title XIV of the Act establishes several new protections for residential mortgage loan borrowers and new requirements for those engaged in the residential mortgage lending process, including originators, appraisers and servicers. The Bureau is given rulemaking and enforcement authority over most of the requirements. Some rules are mandated to other federal agencies, including the FRB. Most of the rules mandated under Title XIV must be issued in final form by eighteen months from the Designated Transfer Date and must take effect no more than twelve months later.

1. Residential Mortgage Loan Origination

The Act amends TILA to add restrictions to those acting as "mortgage originators" for residential mortgage loans. The new requirements are in addition to those imposed by the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 ("SAFE Act"). The Act prohibits a mortgage originator from receiving compensation, such as yield spread premiums, based on the terms of residential mortgage loans and generally limits the ability of a mortgage originator to be compensated by others if compensation is received from the consumer.

The FRB is directed to issue rules limiting steering by mortgage originators and prohibiting other practices. Under those rules, mortgage originators would not be permitted to steer a consumer toward residential mortgage loans the consumer lacks the reasonable ability to repay, that have predatory characteristics, or that promote disparities among consumers of equal creditworthiness, but different race, ethnicity, gender or age. The rules must also prohibit mortgage originators from steering a consumer to a non-qualified mortgage if the consumer is qualified to receive a qualified mortgage, as that term is defined under Section 129C(b)(2) of TILA. The FRB is required to issue rules prohibiting mortgage originators from mischaracterizing the creditworthiness of the consumer, the residential mortgage loans available to the consumer and the appraised value of a property. The FRB is given additional authority to issue rules to prohibit abusive, unfair, deceptive or predatory practices. Mortgage originators are held to the liability standards in TILA applicable to creditors and are liable to injured consumers up to three times the compensation received for the residential mortgage loan.

The Act mandates the Secretary of Housing and Urban Development (the "HUD Secretary") to conduct a comprehensive study, in consultation with other agencies, to

determine prudent statutory and regulatory requirements regarding shared appreciation mortgages. A report on the subject must be delivered to Congress by January 21, 2011.

2. Minimum Mortgage Standards

The FRB must also adopt regulations requiring creditors to make a reasonable and good faith determination that consumers have the reasonable ability to repay their mortgage loans. This requirement is discussed in greater detail in Section II.G.

3. High Cost Mortgages

The Act amends TILA to include additional requirements relating to “high-cost mortgages,” defined in the Act to include mortgages with annual percentage rates or points and fees exceeding thresholds outlined in the Act. For high-cost mortgages, creditors are (1) prohibited from encouraging default on prior debt to be refinanced in whole or in part by a high-cost mortgage, (2) limited in imposing late payment fees on delinquent payments, (3) not allowed to include balloon payments, and (3) prohibited from charging a fee to modify, renew, extend or amend the loan. Acceleration of a high-cost mortgages is permissible only in the event of a default, under a due-on-sale provision, or for a material violation of the loan terms. There are restrictions on creditors financing prepayment penalties, points or fees on high-cost mortgages. Borrowers requesting a payoff statement generally must be provided one without charge and a payoff balance must be provided within five business days after the request. Prior to extending credit under a high-cost mortgage, a creditor must receive certification from a counselor approved by the Department of Housing and Urban Development (“HUD”) that the consumer has received counseling about the advisability of entering into the loan, and consumers must receive the disclosure statement required by the Real Estate Settlement Procedures Act (“RESPA”) prior to speaking with the counselor.

4. Office of Housing Counseling

The Act creates the Office of Housing Counseling (the “OHC”) to oversee required home ownership and renter’s counseling and certain educational materials. The new office will have a director appointed by the HUD Secretary and is given rulemaking authority for the counseling and consumer education requirements under several federal laws relating to residential mortgage loans, home ownership and rental housing. Those seeking to provide consumer counseling under several federal housing laws must be certified by the OHC.

The HUD Secretary is required to “conduct an extensive study of the root causes of default and foreclosure of home loans.” A preliminary report must be submitted to Congress by July 21, 2011 (and a final report by July 21, 2012). The HUD Secretary, in consultation with other agencies, is also required to establish and maintain a database on residential mortgage loan foreclosures and defaults.

5. Mortgage Servicing

The Act imposes new requirements relating to mortgage servicing, primarily relating to escrow accounts and the crediting of payments. The Act amends TILA to require, prior to consummation, a creditor to establish an escrow or impound account for most mortgage loans secured by a first-lien on a consumer’s primary residence. The escrow or impound account is to be used to pay taxes and hazard insurance and, if applicable, certain other costs with respect to the secured property and must remain in place for at least five years after the consummation of the loan. Certain consumer disclosures relating to the escrow or impound account are also required.

Mortgage servicers are prohibited from engaging in certain practices, including obtaining force-placed hazard insurance, unless exemptions apply, or charging fees for responding to valid qualified written requests from consumers. Mortgage servicers must also make a timely response to alleged payment allocation errors and respond within ten business days to an information request from a consumer relating to the owner or assignee of the loan. For payments received, mortgage servicers must generally apply the payment amount to the loan account on the date of receipt. If the mortgage servicer has specified to the consumer in writing requirements for the receipt of payments that are not followed by the consumer in making a payment, the mortgage servicer, if accepting the payment, must credit the payment to the loan account within five days of receipt. If a written request for a payoff amount is received by a creditor or mortgage servicer, the payoff amount must be provided within a reasonable time not to exceed seven business days.

6. Appraisal Requirements

For “higher-risk mortgages,” as defined under the Act, the Act imposes additional requirements relating to appraisals of the mortgaged property. A creditor for a higher-risk mortgage must, prior to extending credit and at no cost to the applicant, obtain an appraisal from a certified or licensed appraiser that includes a physical property visit. In certain circumstances, a second appraisal may be required. The Act also sets standards for appraisal independence and requires several regulatory agencies to set rules for the registration and supervision of appraisal management companies. For automated valuation models, the Act requires quality control standards and requires regulators to issue rules on the subject.

7. Mortgage Resolution and Modification

The Act requires the HUD Secretary to establish a program to protect tenants and at-risk multifamily properties. The Treasury Secretary is also required to develop guidelines that permit borrowers denied a request for mortgage modification under the Home Affordable Modification Program to receive all borrower-related and mortgage-related input data used in net present value analyses done in connection the borrower’s loan and to establish a website that provides a calculator for net present value analysis.

8. Other Provisions

The final subpart of Title XIV includes certain other mortgage-related provisions, including a sense of Congress statement on structural reform for government-sponsored enterprises, a mandate for the GAO to conduct a study on interagency efforts to address mortgage foreclosure rescue scams, and a HUD mandate to study the effects of Chinese drywall on residential mortgage foreclosures. The Act makes available to the HUD Secretary funds necessary to provide \$1 billion in emergency mortgage assistance and \$1 billion for state and local governments for the redevelopment of abandoned and foreclosed homes. The HUD Secretary is required to establish a grant-making program for legal assistance to low- and moderate-income homeowners and tenants relating to home ownership preservation, foreclosure prevention and tenancy associated with home foreclosure.

Although most mortgage-related provisions in the Act are contained in Title XIV, a few are included in Title X. The Act requires the Bureau to issue, within one year after the Designated Transfer Date, a proposed rule containing model disclosures combining disclosures required under TILA and Sections 4 and 5 of RESPA, unless the Bureau determines that proposals issued by the FRB and HUD fulfill this purpose. Among

amendments to the SAFE Act, the requirement to establish and maintain a system for registering employees of depository institutions and their subsidiaries regulated by a federal banking agency as registered loan originators with the Nationwide Mortgage Licensing System and Registry is transferred to the Bureau.

D. Improving Access to Mainstream Financial Institutions (Title XII)

1. Expanded Access to Mainstream Financial Institutions

Title XII of the Act authorizes the Treasury Secretary to establish a multiyear program of grants, cooperative agreements, financial agency agreements, and similar undertakings to promote initiatives designed to enable low- and moderate-income individuals to establish deposit, savings and closed-end loan accounts in a federally insured depository institution and to improve access to the provision of such accounts on reasonable terms. Only eligible entities may participate in any such program and offer products and services relating to these accounts, including small-dollar value loans and financial education and counseling. An eligible entity includes a 501(c)(3) nonprofit, a federally insured depository institution, a community development financial institution, a state, local or tribal governmental entity or a partnership or other joint venture comprised of one or more of the foregoing entities as prescribed in regulations to be issued.

2. Low-Cost Alternatives to Small Dollar Value Loans

The Treasury Secretary is further authorized to establish multiyear demonstration programs by means of grants, cooperative agreements, financial agency agreements, and similar undertakings with eligible entities to provide low-cost, small loans to consumers that will provide alternatives to more costly small dollar loans. Each eligible entity awarded a grant must promote the provision of financial literacy and education opportunities to each consumer provided with a loan. The Treasury Secretary also may implement reasonable measures or programs designed to expand access to financial literacy and educational opportunities.

3. Grants to Establish Loan-Loss Reserve Funds

The Act also amends the Community Development Banking and Financial Institutions Act of 1994 (12 U.S.C. 4701 et seq.) to authorize the Community Development Financial Institutions Fund to make grants to community development financial institutions or to any partnerships between such institutions and any other federally insured depository institution with a primary mission to serve targeted investment areas to enable such institutions or partnerships to establish loan-loss reserve funds in order to defray the costs of small dollar loan programs. A small dollar loan program is a loan program in which such an institution or partnership offers loans to consumers in amounts not exceeding \$2,500 that are to be repaid in installments and that do not have a prepayment penalty and for which the institution reports loan payments to at least one nationwide consumer reporting agency. Participating institutions or partnerships must provide non-Federal matching funds equal to fifty-percent of the grant amount received. The grants cannot be used to provide direct loans to consumers but may be used to recapture a portion or all of a defaulted loan made under the small dollar loan program and to utilize a fiscal agent for certain services.

E. Pre-Dispute Arbitration and Specific Bureau Authorities (Title XII)

1. Pre-Dispute Arbitration

The Act mandates that the Bureau make a study of agreements offering or providing consumer financial products that require arbitration for any future dispute between covered entities and consumers. The Act does not provide guidance as to the details of the study, and does not provide temporal limits or subject matters for review. Once the study is completed, the Act requires the Bureau to report to Congress regarding its findings.

The Act also gives the Bureau the authority to limit, condition or even prohibit in their entirety pre-dispute arbitration clauses for consumer financial services contracts, provided that the Bureau finds that such restrictions are “in the public interest and for the protection of the consumers.” The Act does require that any restrictions or prohibitions imposed be “consistent” with the findings of the study regarding pre-dispute arbitration clauses, and expressly exempts post-dispute arbitration agreements from prohibition. Any regulations issued by the Bureau regarding pre-dispute arbitration agreements shall only affect agreements entered into 180 days after the effective date of the regulation.

2. Specific Bureau Authorities

(a) Unfair, Deceptive or Abusive Acts and Practices

The Act grants the Bureau broad authority to take any enforcement action authorized by the Act to prevent any “unfair, deceptive or abusive act or practice” in connection with consumer financial products or services. The Act also grants the Bureau the authority to issue regulations identifying specific acts or practices as “unlawful, unfair, deceptive or abusive,” and provides that such regulations may also include requirements to prevent such acts or practices. The Act requires that the Bureau consult with the other federal banking agencies to ensure consistency in their regulations.

In order to find an act or practice “unfair,” the Bureau must have a reasonable basis to conclude that the act or practice causes or likely will cause substantial injury to consumers that is not reasonably avoidable, and such injury is not outweighed by benefits to consumers or competition. Similarly, in order to find an act or practice “abusive,” such an act or practice must either materially interfere with a consumer’s ability to understand the terms of the product or service, or take advantage of a consumer’s (1) lack of understanding of the risks involved, (2) inability to protect their own interests or (3) reasonable reliance on the covered entity to act in the consumer’s interests. The Act does not provide any guidance as to what acts or practices should be considered “deceptive,” but does find that any “unfair, deceptive or abusive” act or practice shall be “unlawful.” Additionally, a person who knowingly or recklessly provides “substantial assistance” to a covered entity in violation of the prohibition on “unfair, deceptive or abusive” acts or practices violates the Act, although merely providing time or space to a covered person for the advertising of a product or service is not “substantial assistance.”

(b) Specific Grants of Authority

The Act grants the Bureau authority to regulate specific conduct regarding consumer financial products and services. For example, the Act allows the Bureau to issue regulations regarding the disclosure of the terms and features of products and services, both initially and over the life of the product or service, to “permit[] consumers to understand the costs, benefits and risks.” The Bureau may draft “model disclosures” for the disclosures

required by its regulations, and the Act provides that any covered entity using such model disclosures shall be considered in compliance with the Bureau's regulations. The Bureau may also permit covered entities to conduct trial programs regarding modified disclosures designed to improve upon the Bureau's models, and may provide safe harbor benefits to those entities using approved trial disclosures. Additionally, the Act mandates that the Bureau design and propose a single mortgage loan disclosure document combining the requirements of TILA and Sections 4 and 5 of RESPA.

The Act also provides that covered entities must provide to consumers, upon request, information regarding the service or product obtained by the consumer, subject to regulations issued by the Bureau in consultation with the federal banking agencies and the FTC to ensure consistent regulations by all agencies. A consumer can request information "relating to any transaction, series of transactions or to the [consumer's] account including costs, charges and usage data." The covered entity must make such information available in an electronic form usable to consumers, and the Act directs the Bureau to prescribe standards for the development and use of standardized electronic forms. Certain information is excluded from disclosure, however, including confidential commercial information, information collected for the purpose of preventing fraud and money laundering, information deemed confidential by any other law, or information that is not within the covered entity's possession or control or not retrievable in the ordinary course of business. Covered entities must provide such information in a "timely manner," although the Act does not define what is considered "timely." The Act states the failure of a covered entity to provide information as required by this section is "unlawful." Further, although the Act itself does not impose any record-keeping requirements on covered entities, failure to keep records in compliance with other federal laws is also deemed "unlawful."

The Act also requires that the Bureau establish regulations regarding procedures for regulators to provide "a timely response" to complaints or inquiries regarding covered entities. The response must include steps taken by the regulator in response to the complaint or inquiry, any information received by the regulator from the covered entity and any follow-up actions taken or planned by the regulator. The Bureau must enter into memoranda of agreement with other affected regulators to ensure agreement and compliance with any regulations issued under this section. The Act also requires that covered entities provide a "timely" response to inquiries from the Bureau and any other applicable regulators with jurisdiction, including steps taken by the entity in response to the complaint or inquiry, any information received by the consumer and any follow-up actions taken or planned by the entity. The Act does not define what a "timely" response would be, indicating that the timing of a response will be part of any issued regulations. The failure of a covered entity to provide information or reports to the Bureau under this section is considered "unlawful."

F. Mortgage Reform and Predatory Lending Act (Title XIV)

1. Ability to Repay

The Act makes several revisions to TILA, prescribing certain standards that mortgage lenders must consider before making a residential mortgage loan, exempting reverse mortgages or bridge loans with a 12 month or less repayment period. In particular, creditors must make a "reasonable and good faith determination, based on verified and documented information" that the borrower has the ability to repay the mortgage loan, using a fully amortizing payment schedule. If the creditor plans on making more than one loan secured by the same residence, then the determination must be made using the combined payments

of all such loans. In making their “reasonable and good faith determination,” creditors must consider (i) the credit history of the borrower; (ii) current income; (iii) expected future income; (iv) current obligations; (v) debt-to-income ratio or residual income after paying all mortgage and non-mortgage debt; (vi) employment status; and (vii) any other financial resources other than equity in the property. The creditor also must obtain verification of any income or assets used in its repayment determination, such as a review of tax returns, payroll receipts, bank records or other third-party documents. In particular the Act requires that a creditor either use IRS transcripts of tax returns or a third-party income documentation method subject to FRB regulations.

The Act exempts streamlined refinancing made, guaranteed or insured by federal departments or agencies from the income verification requirement, provided that (i) the consumer is not more than 30 days past due on the existing loan; (ii) the refinancing does not increase the balance of the loan outside of allowable fees and charges; (iii) total points and fees do not exceed 3% of the loan amount; (iv) either the interest rate on the refinanced loan is lower than the original loan or the refinancing converts interest rates from adjustable to fixed; (v) payments are fully amortizing over the life of the loan; (vi) there are no balloon payments; and (vii) both the new and old loans satisfy the requirements of the agency or department guaranteeing, making or insuring the new loan.

The Act also provides specific requirements for the repayment determination for “non-standard loans.” For variable rate loans which defer principal or interest payments and interest only loans, the creditor must calculate repayment ability using fully amortizing monthly payments that are substantially equal from month to month, using a fully indexed interest rate. For negative amortization loans, a creditor must consider any balance increase that may accrue over the life of the loan. For refinancing of hybrid loans with the same lender, where the new loan would reduce monthly payments and the borrower has not been delinquent in any payment, a creditor may consider the borrower’s good standing on the existing loan, whether the refinance would prevent future defaults, and offer rate discounts or other favorable terms to such a borrower as would be available to new customers with high credit ratings.

The Act also provides that for loans meeting certain criteria, creditors may presume that such loans have satisfied the repayment determination criteria set forth above. Such loans are considered “qualified mortgages” and must meet the following criteria: (i) the regular periodic payments do not cause the loan balance to increase or defer payment of the principal; (ii) do not result in a balloon payment more than twice as large as the average monthly payment, except in certain limited circumstances; (iii) the income and financial resources of the borrower are verified and documented; (iv) the underwriting process is based on fully amortizing payments including taxes, insurance and assessments; (v) for adjustable rate loans, underwriting is based on the maximum interest rate permitted for the first five years; (vi) the loan complies with any FRB regulations or guidelines regarding debt-to income ratio or alternative measures of ability to pay; (vii) points and fees are less than 3% of the loan amount; and (viii) the loan term is 30 years or less. Reverse mortgage may also be considered “qualified mortgages” if they satisfy the standards for such mortgages as set forth in FRB regulations. The Act requires the FRB to issue regulations adjusting the criteria for points and fees for “small loans” to ensure the flow of credit in areas where home values are lower. The FRB may also issue regulations to effectuate the safe harbor provisions and to adjust the criteria for “qualified mortgages” if the FRB finds such changes necessary to ensure the extension of “responsible, affordable mortgage credit.”

2. Defense to Foreclosure

The Act expressly allows borrowers to assert violations of certain provisions of TILA as a defense by recoupment to a foreclosure complaint. In particular, a borrower can assert violations of the prohibition of so-called “steering incentives” and violations of the requirement that a creditor determine that a borrower can repay the loan as a recoupment defense. The amount of recoupment would be equal to the damages the borrower could receive had they asserted an independent claim, plus attorneys’ fees and costs. Under the Act, the statute of limitations for private rights of action for such violations of TILA does not apply to such recoupment defenses.

3. Prepayment Penalties

The Act further amends TILA to prohibit prepayment penalties for certain mortgage transactions. In particular, a creditor may not charge a “prepayment penalty” for loans that meet any one of the following criteria: (i) they have an adjustable interest rate; (ii) for first lien loans with principal amounts at or below limits set by Freddie Mac, the annual percentage rate is more than 1.5 points above the average prime offer rate for comparable transactions, as published by the FRB (“average prime offer rate”); (iii) for first lien loans with principal amounts above limits set by Freddie Mac, the annual percentage rate is more than 2.5 points above the average prime offer rate; or (iv) for second lien loans, the annual percentage rate is more than 3.5 points above the average prime offer rate. For all other loans, the Act places specific restrictions on prepayment penalties. In particular, for the first year after the loan is consummated, a prepayment penalty cannot exceed 3% of the principal amount. For the second year after the loan is consummated, a penalty cannot exceed 2% of the outstanding balance. For the third year after the loan is consummated, a penalty cannot exceed 1% of the outstanding balance. Beyond the third year after consummation, a creditor cannot require any prepayment penalty as a condition of the loan. Additionally, if a creditor offers a mortgage loan with a prepayment penalty to a borrower, it must also offer the same borrower a mortgage loan with no prepayment penalty as an alternative.

4. Single Payment Credit Insurance

The Act prohibits creditors from financing any insurance policies, including credit life, credit disability, credit unemployment, credit property insurance or any other insurance for debt cancellation or suspension, in connection with a residential mortgage loan or residential HELOC. However, there is no prohibition on such insurance policies if the premiums and fees are not considered financed by the creditor. Additionally, unemployment insurance policies are allowed if the premiums are reasonable, the creditor does not receive any compensation in connection with the premiums, and the insurance contract is with a third party, and not an affiliate of the creditor.

5. Arbitration Agreements

The Act prohibits contracts for residential mortgage loans or residential HELOCs from including terms requiring that the parties submit any disputes to arbitration or non-judicial mediations. The Act also provides that such pre-dispute arbitration provisions cannot be interpreted to bar a consumer from bringing actions in federal court. However, the Act does not prohibit parties from agreeing to engage in arbitration or mediation after a dispute has arisen.

6. Negative Amortization Loans

The Act prohibits a creditor from providing credit secured by a borrower's residence (excluding reverse mortgages), where the terms of the loan may provide for negative amortization of the principal balance, unless the creditor meets certain criteria. In particular, before the transaction is consummated, (i) the creditor must provide the consumer with a statement that discloses the loan may negatively amortize, defines negative amortization in a manner consistent with FRB regulations, and states that negative amortization can increase principal balance and reduces home equity; and (ii) for first time borrowers who do not receive qualified mortgages (defined above in Section G.1, "Ability to Repay"), the borrower submits documentation to the creditor that they have engaged in homeownership counseling from a HUD certified organization.

7. Anti-Deficiency Protections

The Act provides that if a loan is subject to a state law preventing a borrower from being liable for deficiencies on a loan following foreclosure, a creditor must provide a written notice at the time of the loan's consummation describing the protections provided by such anti-deficiency laws and the consequences for consumers of the loss of such protections if the loan is consummated. If a creditor refinances a loan with anti-deficiency protections to a loan without such protections, the creditor must provide a notice, prior to consummation of the loan, describing the protections provided by such anti-deficiency laws and the consequences for consumers of the loss of such protections if the loan is consummated.

8. Partial Payments

The Act requires that creditors disclose to borrowers either prior to settlement, or when the creditor becomes a "creditor" for the loan, the creditor's policy regarding the acceptance of partial payments, and how such partial payments (if accepted) will be applied to the mortgage and escrow balance.

9. Increase to Civil Liability Provisions

The Act amends TILA to extend private rights of action brought under that statute. In particular, the statutory damages for consumer leases will now be no less than \$200 and no greater than \$2,000, and increasing the maximum statutory damages for class actions to the lesser of \$1,000,000 or 1 percent of the creditor's net worth. The Act also extends the statute of limitations for any violation of 15 U.S.C. § 1639 or the newly created Section 129B and 129C of TILA to three years.

10. Lender Rights for Borrower Deception

The Act provides that no creditor or their assignees shall be liable for violations of TILA if the borrower or their co-borrowers have been convicted of obtaining the mortgage by means of actual fraud.

11. Hybrid Adjustable Rate Mortgages

The Act requires that creditors provide certain disclosures for "hybrid adjustable rate loans," defined as loans with an introductory fixed-rate period that adjusts to an adjustable rate period at the expiration of the introductory fixed rate. Between six and seven months before the expiration of the introductory period (or at consummation if the introductory period is six months or less), a creditor must provide a separate written notice to the borrower disclosing (i) the index of formula used to calculate the new rate; (ii) an

explanation of how the interest rate will be calculated including how the index is adjusted; (iii) a good faith estimate of the new monthly payments, including the bases for such an estimate; (iv) a list of alternatives the borrower can pursue prior to the adjustment; and (v) names and contact information for both HUD approved counseling agencies and the applicable state housing finance authority. The FRB may also issue regulations that require creditors to provide similar notices for other adjustable rate loans, even if they are not hybrid adjustable rate loans.

12. Required Disclosures at Consummation

The Act further amends TILA to require that creditor make certain additional disclosure to consumers prior to the extension of credit. For variable or adjustable rate residential mortgage loans involving escrow accounts, creditors must disclose the amount of the initial monthly payments, both with and without escrow payments, and the amount of payments based on the fully indexed rate, both with and without escrow payments. Additionally, creditors must disclose the aggregate amount of all settlement charges in connection with any residential mortgage loan, an approximation of the wholesale rate of funds in connection with the loan and the aggregate amount of any other fees or required payments and identify which charges are financed as part of the loan and which charges must be paid at closing. Creditors also must disclose the aggregate amount of any fees paid to loan originators in connection with the loan, including which fees are paid directly by the consumer and any amounts paid by the creditor to the originator. Finally, creditors must disclose the total amount of interest to be paid over the course of a residential mortgage loan, assuming the borrower makes all payments timely and does not overpay.

13. Required Disclosures in Monthly Statements

The Act amends TILA to require that, for each billing cycle for a residential mortgage loan, the creditor must disclose in billing statements: (i) the amount of principal remaining; (ii) the current interest rate; (iii) the date, if any, that the interest rate will adjust; (iv) the amount of any prepayment penalty, if any; (v) description of late payment fees; (vi) telephone number and email address to obtain information on the loan; (vii) names and contact information for HUD approved counseling agencies; and (viii) any other information required by FRB regulations. The Act also directs the FRB to issue regulations and develop a standard form for such disclosures. The Act further exempts creditors from this requirement in monthly statements if they provide a coupon book at consummation of the transaction that provides the information required by the amendment.

14. Report by the GAO

The Act further directs the Comptroller General to conduct a study of the effect of these provisions of the Act on the availability and affordability of credit for consumers and small businesses, including a variety of specific effects on purchase of residential property by consumers.

G. Enforcement Powers of the Bureau (Title X, Subtitle E)

1. Investigations and Administrative Discovery

Under Section 1052 of the Act, the Bureau may, either by itself or in cooperation with other federal agencies such as the Department of Housing and Urban Development, conduct an investigation into possible violations of the federal consumer financial laws. The Act vests significant investigatory powers in the Bureau. In connection with an enforcement hearing,

the Bureau may issue subpoenas, enforceable in the U.S. district courts, for witness testimony or the production of documents or other material. In addition, before any enforcement proceeding has commenced, the Bureau may issue written civil investigative demands requiring the recipient to produce documents or other material, to submit written reports or answers to questions, and/or to give oral testimony. Where the recipient of such a demand fails or refuses to comply with the demand, the Bureau may petition a U.S. district court for an order enforcing the demand.

Written demands issued by the Bureau must state the nature of the conduct constituting the alleged violation being investigated and the applicable provision of law, describe the information requested with enough clarity to permit the information to be fairly identified, set forth a time for responding, and identify a custodian to whom any materials should be submitted. When producing documents, tangible things, or written responses in response to a demand, the respondent is required to submit a sworn certificate verifying that all responsive materials or information in the possession, custody, control, or knowledge of the person to whom the demand is directed have been submitted. If a person is compelled to give oral testimony in response to a demand, that person may be represented by an attorney, who may advise the person with respect to any question asked of such person and object to questions where it is claimed that the person may refuse to answer the question. Following the giving of oral testimony, the witness may examine the transcript and make any desired changes in form or substance.

Documents and tangible things produced in response to a demand will be subject to requirements and procedures regarding confidentiality, in accordance with rules established by the Bureau. Notwithstanding any such rules, materials produced may be disclosed to either House of Congress or to an appropriate committee of the Congress.

The recipient of a demand may petition the Bureau for an order by the Bureau modifying or setting aside the demand. Any such petition must specify each ground upon which the petitioner relies, including failure of the demand to comply with the provisions of the Act or any constitutional or other legal right or privilege. The time permitted for compliance with the demand is tolled during the pendency of such a petition, except that the recipient must comply with any portions of the demand not sought to be modified or set aside.

2. Hearings and Adjudication Proceedings

Section 1053 of the Act authorizes the Bureau to conduct hearings and adjudication proceedings in the manner set forth in the Administrative Procedure Act in order to ensure or enforce compliance with the Act itself, the Bureau's rules implementing the Act, and any other Federal law or regulation that the Bureau is authorized to enforce. In addition, the Bureau is authorized to conduct special proceedings to issue cease-and-desist orders if it believes a covered person or service provider is engaging or has engaged in an activity that violates a law, rule, or any condition imposed in writing on the person by the Bureau.

In the latter instance, the Bureau must issue a notice to the person or service provider that contains a statement of facts constituting the alleged violation or violations and fixes a time and place for hearing. The recipient must appear at the hearing personally or by its representative to contest the charges, or will be deemed to have consented to the issuance of a cease-and-desist order. If consent is given or if, following the hearing, the Bureau finds that any violation identified in the notice has been established, the Bureau may issue an

order directing the recipient to cease and desist from the violation or practice and/or to take action to remedy the results of the violation.

Prior to conducting any hearing, if the Bureau determines that the violation specified in the notice of charges is likely to cause the recipient to be insolvent or otherwise prejudice the interests of consumers before the completion of proceedings, it may issue a temporary order requiring the person to cease and desist from the violation and/or to take affirmative action to prevent any such prejudice pending completion of the proceedings. Within ten days of service of a temporary cease-and-desist order, the recipient may seek an injunction against the enforcement of the order in federal district court.

The Bureau may seek enforcement of any permanent or temporary cease-and-desist order in a U.S. district court. In addition, within 30 days of the issuance of a final cease-and-desist order, any party to the proceeding may file a petition in the U.S. Court of Appeals seeking that the order be modified, terminated, or set aside. Unless and until the record of the proceeding has been filed in the Court of Appeals, the Bureau itself may modify, terminate, or set aside the order; thereafter, it may only modify, terminate, or set aside the order with permission of the court. The filing of such an appeal does not operate as a stay of the order unless otherwise specified by the court.

3. Litigation Authority

Section 1054 of the Act empowers the Bureau, acting in its own name, to commence civil actions to seek imposition of a civil penalty or appropriate legal or equitable relief for the violation of a federal consumer financial law. The Bureau may, with approval of the court, compromise or settle any such action.

4. Relief Available

In any action or adjudication proceeding brought under federal consumer financial law, the court and/or Bureau may grant any appropriate legal or equitable relief. Exemplary or punitive damages are not available; however, the following forms of relief may be granted, without limitation: (A) rescission or reformation of contracts; (B) refund of moneys or return of real property; (C) restitution; (D) disgorgement or compensation for unjust enrichment; (E) payment of damages or other monetary relief; (F) public notification regarding the violation, including the costs of notification; (G) limits on the activities or functions of the person; and (H) civil money penalties.

The Act makes civil money penalties mandatory in certain circumstances, specifying that any person that violates any provision of federal consumer financial law “shall forfeit and pay a civil penalty.” The amount of a civil penalty depends upon a variety of factors, including the defendant’s financial resources and good faith, the seriousness of the violation, the severity of the risks to or losses of the consumer, and the history of prior violations. Civil penalties may in most instances not exceed \$5,000 for each day during which a violation continues, but may be as much as \$25,000 per day (in the case of a reckless violation of a federal consumer financial law) or \$1,000,000 per day (in the case of a knowing violation of a federal consumer financial law).

In addition to the foregoing forms of relief, in any action brought by the Bureau, a State attorney general, or a State regulator to enforce any federal consumer financial law, the charging authority, if it prevails, may recover its costs in connection with prosecuting the action.

5. Other Enforcement

If the Bureau obtains evidence that any person has engaged in conduct that may constitute a violation of federal criminal law, it is required to provide such evidence to the Attorney General, who may then institute a criminal action.

In addition, section 1057 of the Act contains whistleblower protection provisions prohibiting any covered person or service provider from terminating or otherwise discriminating against an employee who (A) provides information to the employer, the Bureau, or any other State, local, or Federal, government authority or law enforcement agency relating to any violation of, or any act or omission that the employee reasonably believes to be a violation of, any law subject to the Bureau's jurisdiction; (B) testifies in a proceeding related to the administration or enforcement of a law that is subject to the jurisdiction of the Bureau; (C) files or causes to be filed a proceeding under federal consumer financial law; or (D) objects to or refuses to participate in activities or policies that the employee reasonably believes to be in violation of any law subject to the Bureau's jurisdiction.

An employee who believes that he or she has been discharged or otherwise discriminated against for any of these reasons may file a complaint with the Secretary of Labor. If the complaint makes a prima facie showing of such unlawful discrimination, the Secretary of Labor must then send a written notification of the complaint to the person alleged to have committed the violation and initiate an investigation into the allegations of the complaint. After the Secretary of Labor issues an initial determination as to the merit of the complaint, either the complainant or the respondent may file objections and seek a hearing on the issue. If the allegations are found to have merit, the Secretary of Labor may require the respondent to take affirmative action to abate the violation; to reinstate the complainant to his or her former position, together with compensation (including back pay); and/or to provide compensatory damages.

Either the complainant or the Secretary of Labor may file suit in federal district court to enforce such an order. In addition, any person adversely affected or aggrieved by the Secretary's final order may file a petition for review of the order in the U.S. Court of Appeals. The filing of such an appeal does not operate as a stay of the order unless otherwise specified by the court.

III. Payment, Clearing and Settlement Supervision (Title VIII)

The purpose of Title VIII of the Act is to mitigate systemic risk in the financial system and promote financial stability by enhancing the regulation and supervision of systemically important payment, clearing and settlement activities.

A. Designated Financial Market Utilities and Designated Activities

Title VIII authorizes the newly created Council to designate (i) financial market utilities ("designated financial market utilities") or (ii) payment, clearing or settlement activities ("designated activities") that are, or are likely to become, systemically important.

- A financial market utility includes any person that manages or operates a multilateral system for the purpose of transferring, clearing or settling payments, securities or other financial transactions among financial institutions or between financial institutions and

the person but excludes various specified securities exchanges, trading associations, swap facilities, brokers, transfer agents and investment companies.

- A payment, clearing or settlement activity is defined as an activity carried out by one or more financial institutions to facilitate the completion of financial transactions but does not include any offer or sale of a security or any quotation, order entry, negotiation or other pre-trade activity or execution activity.
- A financial transaction includes fund transfers, securities contracts, future contracts, forward contracts, repurchase agreements, swaps, foreign exchange contracts and financial derivative contracts.

The Act sets forth a process for the Council to follow in making its designations of systemic importance, including the factors to be taken into consideration by the Council, required consultation with the FRB and the relevant primary regulator, advance notice and an opportunity for a hearing and the required vote of Council members.

B. Risk Management Standards

The FRB is required to prescribe risk management standards applicable to designated financial market utilities and financial institutions that engage in designated activities, except that the CFTC and the SEC are responsible for prescribing regulations for designated clearing entities and certain financial institutions under their supervision. The standards may address areas such as risk management policies and procedures, margin and collateral requirements, participant or counterparty default policies and procedures, the ability to complete timely clearing and settlement and capital and financial resource requirements.

C. Access to the Discount Window

Title VIII provides that the FRB may extend to a designated financial market utility access to the Federal Reserve discount window in unusual or exigent circumstances and upon a showing by the designated financial market utility that it is unable to secure adequate credit accommodations from other banking institutions.

D. Advance Notice of Proposed Changes

A designated financial market utility is required to provide 60 days advance notice to its primary regulator of any proposed change to its rules, procedures or operations that could materially affect the nature or level of risks presented by the designated financial utility. If the primary regulator objects, the proposed change cannot be implemented.

E. Examination and Enforcement

Each primary regulator of a designated financial market utility is granted examination and enforcement authority with respect to matters under Title VIII. If a service integral to the operation of a designated financial market utility is performed by a third party, the primary regulator may examine whether the provision of that service is in compliance with Title VIII. The FRB may, in its discretion, participate in any examination of a designated financial market utility. The FRB may also request a primary regulator to take enforcement action against a designated financial market utility.

A financial institution that engages in a designated activity will be subject to examination and enforcement by its primary regulator with respect to the designated activity. The FRB

may conduct or participate in such examination or take enforcement action against a financial institution if requested to do so by the financial institution's primary regulator. The FRB is also given backup examination and enforcement authority, which can be exercised only if the FRB has reasonable cause to believe that the financial institution is not in compliance with Title VIII.

F. Reporting Requirements

Title VIII further authorizes the Council or the FRB to require designated financial market utilities and financial institutions that engage in designated activities to submit reports or data in such frequency and form as deemed necessary by the Council or the FRB.

IV. Advisers Act Amendments Including Elimination Of Private Adviser Exemption (Title IV)

A. Changes to Advisers Act Exemptions/Exclusions

The Act eliminates the "private adviser" exemption, which generally exempts an adviser with fewer than 15 clients from registration under the Advisers Act (a private fund is generally treated as a single "client" for this purpose). The Act also creates exemptions (or modifies existing exemptions in the case of advisers registered with the CFTC) from Advisers Act registration for: (i) advisers to "venture capital funds" (a term to be defined by the SEC); (ii) "foreign private advisers," generally those with limited assets under management attributable to U.S. persons; (iii) advisers that only advise funds excluded from the definition of "investment company" under Sections 3(c)(1) or 3(c)(7) of the 1940 Act ("private funds") and have under \$150 million in assets under management; (iv) advisers registered with the CFTC (unless they render predominantly securities-related advice); and (v) advisers to licensed small business investment companies. The Act also directs the SEC to take into account various factors, such as perceived systemic risks, when regulating advisers to "mid-sized private funds" (without defining "mid-sized private fund"). In addition, the Act creates a new exclusion from the definition of "investment adviser" for any "family office" (another term to be defined by the SEC).

B. New \$100 Million Threshold for SEC Registration

The Act increases the assets under management threshold requiring Advisers Act registration (from the current \$25 million threshold), although the increased threshold does not apply to advisers to certain regulated entities, such as registered funds. As a general matter, if an adviser has less than \$100 million in assets under management, and is required to be registered (and subject to examination) in the state in which it maintains its principal office, the adviser may not register with the SEC (unless it has at least \$25 million in assets under management and, by operation of the Act, would be required to register with 15 or more states).

C. Recordkeeping and Reporting

The Act provides the SEC with new recordkeeping, reporting and inspection authority over registered investment advisers. For example, a registered adviser must maintain (and submit for SEC inspection) records regarding its private funds as follows: (i) the amount of assets under management and use of leverage, including off-balance-sheet leverage; (ii) counterparty credit risk exposure; (iii) trading and investment positions; (iv) valuation policies and practices; (v) types of assets held; (vi) side arrangements or side letters; and

(vii) trading practices. The Act also requires certain advisers that are exempt from registration, including under the “venture capital fund” exemption, to maintain records and provide reports as determined by SEC rulemaking.

D. Information Sharing Regarding Private Funds

The Act requires the SEC to make available to the Council copies of all reports, documents, records and information filed with or provided to the SEC by an investment adviser as the Council considers necessary for assessing any systemic risk a private fund may pose. The SEC and the Council are required to keep any such information received by them confidential, subject to certain exceptions for disclosures to Congress, other federal agencies, self-regulatory organizations and the federal courts, which in turn must maintain the confidentiality of the information.

E. Effectiveness

The foregoing amendments to the Advisers Act are effective July 21, 2011.

Please see the [July 23, 2010 Goodwin Procter Client Alert](#) for additional information on these exemptions, as well as the recordkeeping and reporting requirements that apply to certain advisers (notwithstanding their exemption from registration).

V. Derivatives

A. Parallel Regimes for Swaps and Security-Based Swaps

The Act tasks the CFTC and the SEC with parallel rulemaking, supervision and enforcement of derivative transactions and most derivative market participants. (Section 712.) The CFTC’s jurisdiction is based on a broad definition of swaps. (Section 721.) The SEC’s jurisdiction, on the other hand, is confined to security-based swaps, which are generally swaps based on a single security or loan or referencing a single issuer or issuers in a narrow-based index. (Section 761.)

The Act expands the scope of CFTC and SEC regulation of swaps and security-based swaps, respectively, adding a prohibition on insider trading under the Commodity Exchange Act (the “CEA”) (Section 746) and granting authority to the CFTC to promulgate regulations by July 21, 2011 to prevent manipulation and the delivery of false information (Section 753). The Act expressly repeals and amends provisions of the Gramm-Leach-Bliley Act and provides that a security-based swap is explicitly a “security” for purposes of federal securities laws, making these instruments subject to the full panoply of regulations and rules applicable to other securities. In addition, the Act gives the SEC rulemaking authority, subject to consultation with the Prudential Regulators (as defined below) and the Treasury, to incorporate security-based swaps into the reporting requirements of Section 13 (beneficial ownership) and Section 16 (short swing profits) of the 1934 Act (as discussed in more detail in Section VIII.E.6. below). (Section 766.)

B. Certain Key Derivatives Market Participants Subject to New Standards

The Act identifies certain categories of key participants in the derivatives markets, namely – security-based swap dealers, swap dealers, major security-based swap and major swap participants, as being subject to heightened regulation and standards of conduct by the SEC and CFTC, respectively. These categories will be defined by CFTC and SEC rulemaking, which must be complete by July 16, 2011.

Bank regulators – the FRB, the Office of the Comptroller of the Currency and the FDIC (collectively, the “Prudential Regulators”) will continue to have prudential regulatory authority over participants (including swap dealers and security-based swap dealers) in the derivatives markets that are banks and other financial institutions subject to prudential regulation. (See “Swaps Push Out Rule” above in Section I.N. for a discussion of the “push out” rules affecting the swaps activities of banks and other financial institutions).

C. Swap and Security-Based Swap Dealers and Major Swap and Security-Based Swap Participants Subject to Registration, Capital and Reporting Requirements

Swap and security-based swap dealers and major swap and security-based swap participants (including banks) (a) if engaged in swaps transactions, must register with the CFTC, (b) if engaged in security-based swaps transactions, must register with the SEC, and (c) if engaged in both types of transactions, must register with both regulators. Along with registration, these derivatives markets participants are subject to a host of new reporting (including daily transaction reporting) and disclosure rules, minimum capital, operational standards and business conduct rules. (Section 723(a), Section 763(a).)

D. Obligations to Counterparties and Duties to Special Entities

The Act imposes new, heightened duties on swap and security-based swap dealers and major swap and security-based swap participants when entering into derivatives transactions, including verifying that their counterparties are eligible participants and disclosing the material characteristics of the transaction. When facing a counterparty that is one of the “special entities,” including federal agencies, municipalities and other political subdivisions, as well as pension, endowment and retirement plans, swap and security-based swap dealers and major swap and security-based swap participants have additional obligations, including confirming that that counterparty has an independent representative that, among other requirements, has sufficient knowledge to evaluate a transaction and its risks, that is further not subject to statutory disqualification, that is independent and that undertakes a duty to act in the best interests of the special entity. A swap and security-based swap dealer or major swap or security-based swap participant advising a special entity must act in the best interests of that special entity. (Section 731, Section 764.)

E. Mandatory Clearing and Exchange Trading; Additional Capital and Margin Requirements for Uncleared Contracts

The Act mandates clearing for most swaps and security-based swaps through a derivatives clearing organization or clearing agency registered for that purpose with the CFTC or the SEC, respectively, subject to limited exceptions, including for certain commercial end users who are not themselves swap or security-based swap dealers or major swap or security-based swap participants. (Section 723(a), Section 763(a).) The clearing requirement does not apply to transactions entered into prior to the effective date of the applicable agency’s enacting rules.

The Prudential Regulators are required to impose initial and variation margin and capital requirements on counterparties to all transactions that are not cleared by a registered derivatives clearing organization or clearing agency, with no express exceptions for commercial end-users. The SEC and the CFTC are also required to establish comparable margin requirements for non-bank swap and security-based swap dealers and major swap and security-based swap participants for uncleared transactions. (Section 731, Section 764.)

F. Clearing Agencies, Derivatives Clearing Organizations and Swap Repositories

Clearing agencies and swap repositories, among others, must register with both the CFTC and the SEC to the extent clearing (or collecting information, as applicable) swaps and security-based swaps, and, upon registration, will be subject to substantial compliance, risk management, recordkeeping, reporting and disclosure obligations. (Section 725, Section 763(b).)

G. Mandatory Transaction Reporting

The Act requires that nearly all market participants report their swap and security-based swap transactions. Counterparties to transactions have independent reporting obligations under the Act, with daily transaction reporting required of swap and security-based swap dealers and major swap and security-based swap participants. Counterparties to transactions entered into prior to July 21, 2010 are required to be reported no later than January 17, 2011. (Section 723(a), Section 763(a).)

Clearing agencies, exchanges, alternative swap execution facilities and swap repositories are required to report transaction information to the CFTC or the SEC, as applicable, certain of which information will be shared with the SEC/CFTC, the FRB, other governmental agencies and federal financial supervisors.

H. Position Limits

The SEC and CFTC have rulemaking authority to set aggregate position limits for “large traders” as “necessary or appropriate in the public interest or for the protection of investors.” (Section 737.) The CFTC is required to establish such position limits by January 17, 2011 for most commodities.

I. Extraterritoriality; International Cooperation

The Act generally does not apply to activities outside the U.S., but does reach certain derivatives activities that have an effect on U.S. commerce or violate the SEC and CFTC’s anti-evasion rules. The SEC and CFTC are authorized in certain circumstances, in consultation with the Treasury, to prohibit non-U.S. domiciled participants from participating in U.S. derivatives markets. The Act requires the CFTC, SEC and the Prudential Regulators to cooperate internationally in order to promote effective and consistent regulation of swaps and security-based swaps across national borders.

VI. Executive Compensation

A. Shareholder Approval of Executive Compensation (Say on Pay)

The Act requires every public company to seek an advisory shareholder vote on executive compensation as disclosed pursuant to Item 402 of Regulation S-K. The Act permits shareholders to determine the frequency of “Say on Pay” votes, which must be held annually, bi annually or tri-annually. Public companies must seek a shareholder vote on the frequency of the “Say on Pay” vote at least once every six years.

The Act also requires mandatory disclosure of, and unless previously approved, a shareholder advisory vote on, “golden parachute” arrangements in all change in control proxy or consent solicitation materials. Under this provision, the company making the solicitation must disclose any agreements that the company (or the acquirer) has with any

named executive officer of the company concerning any type of compensation (whether present, deferred or contingent) that is based on or otherwise relates to the change in control transaction, as well as the aggregate total of all such compensation and the circumstances upon which it may be paid.

Both advisory votes are non-binding and will not overrule a decision of the company or its board of directors or otherwise impact the board's fiduciary duties. The SEC is granted authority to exempt an issuer or class of issuers from "Say on Pay" votes, taking into account any disproportionate burdens on small issuers.

The "Say on Pay" shareholder advisory vote is to become effective with the first shareholder meeting occurring after January 21, 2011, and the "golden parachute" advisory vote is to become effective with any shareholder meeting occurring after January 21, 2011 where shareholders are asked to approve change in control transactions. (Section 951.)

B. Compensation Committee Independence

The Act requires the SEC to issue regulations no later than July 16, 2011 that require exchanges to prohibit the listing of any equity securities of any issuer (other than controlled companies, limited partnerships, mutual funds, companies in bankruptcy proceedings and certain foreign private issuers) that does not comply with the enhanced compensation committee independence rules, subject to exemptive relief and cure provisions. The exchanges must require that each compensation committee member be "independent" as defined with reference to relevant factors, including the source of compensation and whether a member is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer.

The Act requires that any compensation consultant, legal counsel or other adviser retained by a compensation committee be selected only after taking into account independence factors to be established by the SEC. The compensation committee is directly responsible for the appointment, compensation and oversight of its compensation consultant, legal counsel or other adviser, but is not required to implement or act consistently with their advice. In addition, each listed company is required to disclose in any proxy statement for a meeting occurring after July 21, 2011 whether the compensation committee retained or obtained the advice of a compensation consultant, the presence, if any, of a conflict of interest and how such conflict is being addressed. (Section 952.)

C. Executive Compensation Disclosures

The Act requires the SEC to amend the proxy rules to require disclosure regarding (a) the relationship between executive compensation and the financial performance of the issuer and (b) the median of the annual total compensation of all its employees, other than the chief executive officer, the annual total compensation of its chief executive officer, and the ratio of these two amounts, with "annual total compensation" determined under the proxy rules in effect prior to the Act. (Section 953.)

D. Recovery of Erroneously Awarded Compensation

The Act requires the SEC to direct the exchanges to prohibit the listing of any security of an issuer that does not adopt a "clawback" policy. Such a policy must provide (i) for disclosure of the issuer's policy on incentive-based compensation that is based on financial information required to be reported under the securities laws and (ii) that in the event of an

accounting restatement due to the issuer's material noncompliance with any financial reporting requirements, the issuer will recover from any current or former executive officer who received incentive-based compensation (including stock options) during the three-year period preceding the date on which the issuer is required to prepare an accounting restatement, any excess compensation above what would have been paid to the executive officer under the accounting restatement. (Section 954.)

E. Disclosure Regarding Employee and Director Hedging

The SEC must require an issuer to disclose in its proxy materials whether any of its employees or directors engaged in hedging activities designed to hedge or offset decreases in the market value of equity securities of the issuer granted as compensation to, or otherwise held by, them. (Section 955.)

F. Enhanced Compensation Structure Reporting

No later than April 21, 2011, the Federal regulators, including the FRB, the FDIC, the OCC and the SEC, must prescribe regulations requiring each covered financial institution to disclose to its Federal regulator the structures of all of its incentive-based compensation arrangements and prohibiting any incentive-based arrangements that the regulators determine encourages inappropriate risk by the covered financial institutions. (Section 956.)

G. Voting by Brokers

The Act requires each national securities exchange to prohibit a member broker-dealer from granting a proxy with respect to executive compensation (and certain other matters as discussed below in Section VII "Corporate Governance") without receiving instructions from the security's beneficial owner. (Section 957.)

VII. Corporate Governance

The Act contains several corporate governance reforms that are applicable to all publicly traded companies. Effective July 21, 2010, the Act gave the SEC express authority to adopt rules that would allow a shareholder to include a director nominee in an issuer's proxy solicitation materials, including the authority to exempt certain issuers and classes of issuers. The Act also requires the SEC by January 17, 2011 to promulgate rules under which a public company's annual proxy statement would have to include an explanation of why the positions of chief executive officer and chairman of the board are separate or combined. (Sections 971 & 972.)

In addition, the Act mandates risk committees, responsible for oversight of enterprise-wide risk management practices, for publicly-traded Systemically Significant Nonbank Financial Companies and for any publicly-traded bank holding companies with total consolidated assets of \$10 billion or more. The Act empowers the FRB to require risk committees for publicly-traded bank holding companies with less than \$10 billion in assets as necessary or appropriate to promote sound risk management practices. The Act requires risk committees to include such number of independent directors as may be specified by the FRB, and one risk management expert having experience in risk management at large complex companies. The FRB must promulgate rules relating to risk committees by July 21, 2011, subject to a six-month extension. (Section 165(h).)

The Act also amends Section 404 of the Sarbanes-Oxley Act by exempting non-accelerated filers (i.e., generally, those companies with less than \$75 million of non-affiliate common equity market capitalization) from the requirement to provide an independent auditor attestation of management's assessment of the effectiveness of the company's internal control over financial reporting. These companies will still be required to maintain internal control over financial reporting and assess the effectiveness of their internal controls on an annual basis. (The SEC has delayed the implementation of this requirement for non-accelerated filers several times since the Sarbanes-Oxley Act was enacted.) The Act also requires the SEC to conduct a study to determine how it could reduce the burden of Section 404(b) of the Sarbanes-Oxley Act on companies with market capitalization between \$75 million and \$250 million. (Section 989G.)

The Act imposes several additional requirements relating to executive compensation by public companies and to the independence of members of a public company's compensation committee. For a discussion of executive compensation reform, please see Section VI of this Alert.

The Act requires each national securities exchange to prohibit a member broker-dealer from granting a proxy with respect to director elections (other than an uncontested election for a registered investment company), executive compensation, or any other significant matter, as determined by the SEC, without receiving instructions from the security's beneficial owner. (Section 957.)

VIII. Other Securities Regulation Reform

A. Regulation D

The Act provides that until July 21, 2014, the "net worth" threshold for a natural person to qualify as an "accredited investor" under the 1933 Act's rules, including Regulation D, is \$1 million, excluding the value of the person's primary residence. At any time after enactment, the SEC is permitted to review and revise the accredited investor requirements for natural persons (other than the net worth threshold, which is subject to adjustment as discussed below). Moreover, beginning July 21, 2014, at least every four years, the SEC must review the entire accredited investor definition as it applies to natural persons and consider adjustments thereto, provided that the net worth threshold must always exceed \$1 million (excluding primary residence value). (Note that under the Act as currently in effect, this direction applies solely to the definition of "accredited investor" in Rule 215 under the 1933 Act and not to the same term used in Regulation D.) (Section 413.)

No later than July 21, 2011, the SEC must promulgate regulations excluding any offering from Regulation D if the person making the offering has been convicted of certain misdeeds (e.g., a felony in connection with a securities sale) or barred from engaging in certain activities (e.g., engaging in a securities business) due to fraud or similar bad acts. (Section 926.)

The GAO must report to Congress no later than July 21, 2013 regarding the accredited investor criteria and the eligibility to invest in private funds (presumably with recommendations regarding whether, for example, such criteria should be adjusted). (Section 415.)

B. Broker-Dealer and Adviser Standard of Care and Oversight

1. Broker-Dealer and Investment Adviser Standards of Conduct

The Act does not establish a fiduciary duty or other standard of conduct for broker-dealers, but requires the SEC to conduct a study regarding the standards of care applicable to broker-dealers and investment advisers in providing personalized investment advice and recommendations about securities to “retail customers.” The Act also gives the SEC express authority to adopt rules regarding those standards of care based on the study’s findings. The SEC may adopt rules that require a broker-dealer or investment adviser providing personalized investment advice to a retail customer (or any other type of customer the SEC may designate) to act in the best interest of the customer without regard for the financial and other interest of the broker-dealer or investment adviser providing the advice. Any such standard of conduct must be no less stringent than the standard under the anti-fraud provisions of Section 206(1) and (2) of the Advisers Act applicable to the provision of personalized investment advice about securities, and the SEC must not ascribe a meaning to the term “customer” that would include an investor in a private fund when the private fund has entered into an advisory contract with the investment adviser. The Act defines a “retail customer” for purposes of the foregoing provisions as “a natural person, or the legal representative of such natural person, who (1) receives personalized investment advice about securities from a broker or dealer or investment adviser; and (2) uses such advice primarily for personal, family or household purposes.” From a timing perspective, the SEC must submit its report (considering certain specified issues) to Congress by January 21, 2011. Presumably, any rulemaking will follow this report, but no specific timeframe is identified. (Section 913.)

2. Disclosure, Sales Practices, Conflicts of Interest and Compensation Schemes

The Act authorizes the SEC to adopt rules requiring a broker-dealer that sells only a proprietary or other limited range of products to provide notice to each retail customer (as defined above) and obtain the customer’s consent or acknowledgment, provided that the sale of only a proprietary or other limited range of products shall not, in and of itself, be considered a violation of the “best interests” standard of conduct discussed above. (Section 913.) The Act directs the SEC to facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with broker-dealers and investment advisers, including any material conflicts of interest, and to examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for broker-dealers and investment advisers that the SEC deems contrary to the public interest and the protection of investors. (Section 913.) These rules are also likely to follow the SEC’s study regarding broker-dealer and investment adviser standards of care, but no timeframe is specified. Separately, the Act gives the SEC general authority to adopt rules to protect “retail investors” (a term not defined in the Act) by designating documents or information that a broker-dealer must provide to a retail investor before the retail investor purchases an investment product or service. (Section 919.)

C. Securities Litigation

The Act clarifies and supplements existing rules and, in some cases, creates entirely new tools – both procedural and substantive – designed to promote the litigation efforts of the SEC and private investors. Significant changes effected by the Act include the following:

1. SEC Authority to Restrict Pre-Suit Arbitration

The Act empowers the SEC to limit or prohibit the enforcement of arbitration agreements that require customers or clients of any broker, dealer, or municipal securities dealer to arbitrate disputes arising under federal securities laws or regulations, or under the rules of any self-regulatory organization. (Section 921.) The statute also prohibits pre-dispute arbitration of employment disputes between whistleblowers and their employees concerning alleged retaliation for whistleblowing activity. (Section 922.)

2. Whistleblower Provisions

The Act provides various incentives and protections to individuals who provide information to the SEC concerning violations of the securities laws. For example, individuals who voluntarily provide “original information” to the SEC leading to the successful enforcement of a judicial or administrative action imposing more than \$1 million in sanctions, shall be compensated with between 10 and 30 percent of the monetary sanctions imposed. (The SEC has discretion to determine the amount of the award, but must be guided by several enumerated factors). Payments will come from a new Investor Protection Fund, which will be funded by monetary sanctions collected by the SEC. The Act prohibits employers from retaliating against whistleblower employees and gives whistleblowers a private cause of action for reinstatement, back pay, fees and costs. These protections may not be contractually waived. Except under limited circumstances, the SEC must keep confidential any information that might reveal the identity of a whistleblower. (Section 922.) The Act clarifies that the Sarbanes Oxley Act of 2002’s whistleblower provisions apply not only to the employees of publicly traded companies, but also to the employees of those companies’ subsidiaries and affiliates. (Section 929A.) The SEC must enact implementing rules by April 17, 2011. (Section 924.)

3. Expanded Scope of Collateral Bars

The Act expands the scope of collateral bars available to the SEC as sanctions against registered brokers, dealers, municipal securities dealers, transfer agents and investment advisers under the 1934 Act and the Advisers Act, so that the SEC may impose a bar on association with a range of regulated entities rather than only being able to impose a bar on association with the type of entity at which the conduct giving rise to the sanction occurred. (Section 925.)

4. Nationwide Service of Subpoenas

In all civil actions brought in a United States District Court by the SEC under the 1933 Act, the 1934 Act, or the 1940 Act, a subpoena may be served at any place within the United States, and any protections ordinary afforded by the 100-mile rule (Fed. R. Civ. P. 45(c)(3)(A)(ii)) will not apply. (Section 929E.)

5. Aiding and Abetting

The Act gives the SEC express authority under the 1933 Act, the 1934 Act, the 1940 Act, and the Advisers Act to pursue claims for aiding and abetting liability based on a standard of knowing or reckless action. (Sections 929M-O.) The Act does not allow for private actions against aiders and abettors, but does authorize a GAO study on the potential impact of such litigation. (Section 929Z.)

6. Extraterritoriality of Antifraud Provisions

The Act extends the jurisdiction of the United States District Courts and the federal courts of any United States territory to encompass actions brought by the SEC that involve either (a) conduct within the United States that constitutes significant steps in furtherance of a violation of the federal securities laws, even if the securities transaction occurs outside the United States and involves only foreign investors; or (b) conduct occurring outside the United States that has a foreseeable substantial effect within the United States. (Section 929P(b).)

7. Audits of Foreign Accountants

The Act empowers the SEC to compel a foreign public accounting firm that performs material services on which a domestic registered public accounting firm relies to produce its audit work papers and all other documents related to its audit or interim review work, and subjects the foreign public accounting firm to the jurisdiction of the U.S. federal courts for the purpose of that production. Any foreign public accounting firm that performs work for a domestic public accounting firm must provide that domestic firm with an irrevocable consent and power of attorney that designates the domestic firm as an agent upon whom process, papers, pleadings and any requests from the SEC or the Public Company Accounting Oversight Board (“PCAOB”) may be served. (Section 929J.)

8. Shared Government Privilege

The SEC may, without waiving any privilege, share information with other federal agencies, the PCAOB, self-regulatory organizations, foreign securities regulatory or law enforcement authorities, or state securities regulatory or law enforcement authorities. All of the foregoing (other than foreign securities regulatory or law enforcement authorities) will not waive any privilege applicable to information by transferring that information to the SEC or letting the SEC use it, except as to a self regulatory organization or the PCAOB with respect to information used by the SEC in an action against that entity. The SEC may not be compelled to disclose privileged information obtained from any foreign securities regulatory or law enforcement authority if that foreign authority has in good faith determined and represented to the SEC that the information is privileged. “Privilege” includes any work-product protection, the attorney-client privilege, any governmental privilege, and any other privilege recognized under federal, state, or foreign law. (Section 929K.)

9. Control Person Liability

The Act clarifies that control persons are jointly and severally liable, not only in private actions, but also in SEC enforcement actions brought under Section 20(a) of the 1934 Act. (Section 929P(c).)

10. Other Provisions

Other provisions of the Act that may affect securities litigation practice address the SEC’s ability to bring actions against persons formerly associated with regulated organizations based on actions taken when so associated (Section 929F) and the confidentiality of information provided to the SEC in furtherance of the SEC’s regulatory or oversight activities (Section 929I).

D. Credit Rating Agencies

1. Internal Control

Each NRSRO must establish an internal control structure governing the process for determining credit ratings and must submit an annual report to the SEC describing the internal control structure and its effectiveness. (Section 932(a)(2)(B).)

2. Compliance Officer and Board

The Act imposes new duties and limitations on an NRSRO compliance officer, who must establish procedures for receiving and addressing complaints regarding credit ratings, models, methodologies and compliance with securities laws and submit an annual compliance report to the NRSRO, which is in turn filed with the SEC. The Act prohibits compliance officers from performing credit ratings or participating in the development of ratings methodologies. A compliance officer's salary may no longer be linked to the NRSRO's financial performance. (Section 932(a)(5).) The Act requires each NRSRO to have a board of directors half of whose members are independent and include users of credit ratings. (Section 932(a)(8).)

3. SEC Oversight

The SEC must create an Office of Credit Ratings that will conduct an annual examination of each NRSRO and make its findings available to the public. The Act also gives the SEC the additional remedial authority with respect to NRSROs, including the ability to suspend or revoke an NRSRO's registration with respect to a particular class of securities. (Section 932(a)(8).)

4. Rulemaking - Methodology, Conflicts of Interest, Disclosure

The Act requires the SEC to issue rules that prescribe standards and procedures regarding various aspects of credit rating methodologies, including their creation, approval, application and modification. The SEC is also required to issue rules ensuring that any changes in methodology are applied consistently across all credit ratings to which they are relevant. (Section 932(a)(8).) The Act requires the SEC to issue rules to prevent an NRSRO's sales and marketing considerations from influencing its credit ratings. The Act also requires NRSROs to implement procedures to monitor specified employment transitions by persons between an NRSRO and entities subject to or interested in ratings assigned by the NRSRO, and in certain cases, report them to the SEC. (Section 932(a)(4).) The Act requires the SEC to adopt rules under which NRSROs will provide standardized public disclosures regarding their initial credit ratings and any subsequent changes to the rating. (Section 932(a)(8).) SEC rulemaking regarding credit rating agencies pursuant to the Act must generally be completed by July 21, 2011.

5. Liability

The Act makes the enforcement and penalty provisions of the 1934 Act applicable to statements by NRSROs in the same manner as statements made by a registered public accounting firm or a securities analyst, and prescribes a knowing or reckless standard of pleading in actions for money damages. (Section 933.) The Act nullifies Rule 436(g) under the 1933 Act with the consequence that an issuer who uses a credit rating assigned by an NRSRO in the registration statement for a registered offering will be required to file the NRSRO's consent as an exhibit to its registration statement, subjecting the NRSRO to potential liability under Section 11 of the 1933 Act. (Section 939G.)

E. Miscellaneous Securities Regulation Topics

1. Custody - Advisers and Registered Funds

The Act gives the SEC rulemaking authority to specify the safeguards an adviser must employ for client assets of which it has custody, including auditor verification. (Section 411.)

The Act amends the 1940 Act to require each person having custody or use of registered investment company assets to maintain all records relating to that custody or use for the periods designated by SEC rulemaking. The Act also amends both the 1940 Act and Advisers Act to make persons having custody or use of registered investment company assets or client assets, respectively, subject to SEC examination and document and information requests. (Section 929Q.)

2. Qualified Client Dollar Thresholds

The Act modifies the basis on which the SEC may grant an exemption by rule or regulation from the prohibition under the Advisers Act against advisory fees based on a share of capital gains, by requiring the SEC to make periodic inflation adjustments (the first to take effect by July 21, 2011) to any “dollar amount test” used in a such a rule or regulation (e.g., certain of the “qualified client” tests in Advisers Act Rule 205-3). (Section 418.)

3. Advisers Act Definitions

The Act clarifies the SEC’s ability to adopt rules defining terms used in the Advisers Act, provided that the SEC may not define the term “client” to include an investor in a private fund managed by an investment adviser that has entered into an advisory contract with that adviser. (Section 406.)

4. Removal of Credit Ratings from Agency Rules

The Act requires each federal agency to conduct a review of the use of credit ratings in its rules (e.g., Rule 2a-7 under the 1940 Act applicable to money market funds). Based on that review, each federal agency must remove any reference to or requirement of reliance on credit ratings in its rules and substitute an appropriate standard of creditworthiness. Each agency’s review and related rulemaking must be completed by July 21, 2011. (Section 939A.)

5. Deadlines for SEC Examinations and Investigations

The Act establishes a 180 day deadline (subject to exceptions for complex actions) after the SEC staff issues a Wells notice for the staff to either file an enforcement action against the recipient or notify the Director of the SEC’s Division of Enforcement that no action will be filed. Similarly, the Act sets a 180 day deadline (subject to exceptions for complex actions) following the completion of the onsite portion of an inspection or the SEC staff’s receipt of all records requested from the entity being examined, for the staff to provide that entity with written notification that either that the inspection has concluded, that the inspection has concluded without findings or that the staff requests the entity undertake corrective action. (Section 929U.)

6. Section 13 and Section 16 Reporting

The Act gives the SEC rulemaking authority to shorten the period for filing initial reports under Section 13(d) (5% ownership) and Section 16 (short swing profits) of the 1934 Act. (Section 929R.)

The Act also amends Section 13(d) (5% ownership), Section 13(f) (institutional investment manager) and Section 13(g) (qualified institutional and passive investors) of the 1934 Act to permit the SEC to provide by rule that a purchase or sale of a security based swap is the purchase and sale of a security and as such triggers the reporting requirements of those subsections. The Act further provides that the SEC may also adopt a rule deeming a person to have acquired beneficial ownership of a reference equity security based on the purchase or sale of a security based swap for the purposes of Section 13 or Section 16 (short swing profits) of the 1934 Act. However, the SEC may only promulgate such a rule if it has made certain findings prescribed in the Act following consultation with the Prudential Regulators and the Treasury. (Section 766.)

7. Short Sales

The Act directs the SEC to adopt rules providing for at least monthly public disclosure of short sales by institutional investment managers under Section 13(f) of the 1934 Act. The Act also makes unlawful a “manipulative short sale of any security” and directs the SEC to issue rules to ensure the availability of enforcement options and remedies for violations of this prohibition. (Section 929X.)

8. Securities Lending

The Act creates a requirement that each broker-dealer provide its customers notice that they may elect not to allow their fully paid securities to be used in short sales. A broker-dealer that uses a customer’s securities in a short sale must provide notice to the customer that the broker-dealer may receive compensation in connection with lending the customer’s securities. (Section 4929X.)

The Act gives the SEC express rulemaking authority regarding securities loans and requires it no later than July 21, 2012 to issue rules designed to increase the transparency of information available to broker-dealers and investors with respect to securities loans. (Section 984.)

9. Studies

The Act prescribes a number of studies to be undertaken by the SEC or GAO. Topics include the costs of the Advisers Act custody rule, short sales, the financial literacy of retail investors, mutual fund advertising, investor access to information on broker-dealers and investment advisers, state and federal oversight of financial planners and enhancing investment adviser examinations.

IX. Federal Insurance Office (Title V)

The Act establishes the Federal Insurance Office (“FIO”) within the Treasury. The FIO is not a federal regulator or supervisor of insurance, but will have certain monitoring, reporting and coordinating responsibilities. The FIO also advises the Secretary of the Treasury on insurance matters of international and domestic importance. The Director of

the FIO, who is appointed by the Secretary of the Treasury, will be a career employee and will serve on the Council in an advisory capacity.

1. Functions

The FIO's responsibilities cover all lines of insurance, except for health insurance, long-term care insurance not included with life or annuity insurance products, and crop insurance. The FIO is responsible for: (a) monitoring all aspects of the insurance industry, including identifying insurance issues that could contribute to a systemic crisis in the insurance industry or financial system generally; (b) monitoring whether underserved communities have access to affordable insurance products; (c) recommending to the Council that an insurer be subject to regulation by the FRB as a nonbank financial company; and (d) assisting with the administration of the Terrorism Insurance Program. On the international front, the FIO is responsible for developing federal policy and coordinating efforts relating to international insurance matters.

2. Reports

By January 21, 2012, the Director must conduct a study and submit a report to Congress on how to modernize and improve the system of insurance regulation in the U.S. The report must consider a variety of specified factors, including systemic risk regulation, capital standards and consumer protection. This study must also examine the costs and benefits of potential federal regulation of insurance (except health insurance). The Director must also submit annual reports to the President and Congress on the insurance industry.

3. Preemption

The FIO has limited preemption powers over state laws that are inconsistent with international agreements. The FIO may preempt any state insurance measure if the FIO Director determines that the measure results in less favorable treatment of a foreign insurer than a U.S. insurer and that the measure is inconsistent with an international agreement relating to prudential measures for insurance or reinsurance. However, before making a preemption determination, the FIO must notify interested parties, the appropriate state regulator and the U.S. Trade Representative, publish notice of the matter in the Federal Register, and consider any comments received. The FIO may not preempt state measures governing rates, premiums, underwriting, sales practices, coverage requirements, antitrust laws, or state insurance measures governing insurer capital or solvency unless the measure treats a foreign insurer less favorably than a U.S. insurer.

4. Information Collection

In furtherance of its functions, the FIO has broad authority to collect and analyze data and consult with state insurance regulators. However, before directly requesting information from an insurer or insurer affiliate, the FIO must coordinate with relevant state and federal regulators and agencies to determine whether that information would be available in a timely matter from other sources. If the FIO Director determines the information is not otherwise available, the Director may directly request the information from any insurer that writes insurance in at least one state, or an affiliate of such insurer, provided that the insurer or affiliate meets a minimum size threshold established by the FIO and the FIO complies with the Paperwork Reduction Act. Applicable privileges under federal or state law will not be deemed waived as a result of the information collection process. The FIO also has authority to use subpoenas to collect information under certain circumstances.

X. International Regulatory Oversight and Coordination

The Act contains a number of provisions requiring U.S. regulatory agencies to consult and coordinate with non-U.S. counterpart authorities regarding oversight of foreign bank holding companies and nonbank financial companies. In addition, the Act calls for a wide range of studies relating to global financial sector risk and governmental efforts to respond to it.

In exercising its mandate to identify and regulate systemic risks arising outside of the U.S., the Council is directed to consult with the relevant foreign regulatory authorities with respect to foreign bank holding companies, foreign nonbank financial companies, cross border transactions and international activities, as well as risks to the international financial system generally. Specific requirements in this regard include consultation with home country regulators in connection with “systemic importance” determinations affecting non-U.S. bank and nonbank financial companies, as well as with respect to enhanced prudential standards applicable to such foreign organizations. The OFR is similarly directed to consult with the relevant foreign regulatory authorities when requiring information or reports from non-U.S. banking and nonbank financial companies, and to the extent appropriate, use reports submitted to the relevant foreign agencies. The FDIC is also required to coordinate with appropriate foreign financial regulators in connection with “orderly liquidation” and other supervisory actions involving foreign bank holding companies and nonbank financial companies. The SEC and the CFTC are likewise directed to consult and coordinate with foreign regulatory authorities in setting consistent international standards for regulating swap transactions. Similarly, the FIO is charged with developing policies on the prudential aspects of international insurance matters, and the Secretary of the Treasury and the U.S. Trade Representative are authorized to negotiate international insurance and re-insurance agreements with counterpart non-U.S. governmental authorities.

When making determinations of systemic importance or applying enhanced prudential standards to foreign bank holding companies and nonbank financial companies, the Council, as well as other U.S. financial regulatory agencies are required to consider, among other factors, amount and character of the foreign entity’s assets in the U.S., its liabilities and off-balance sheet exposures, its importance as a source of liquidity and credit in the U.S., while also to taking into account “principles of national treatment and competitive equality,” as well as the extent to which such companies are subject to consolidated home country supervision comparable to U.S. financial organizations.

The Act also calls for numerous studies and reports by, inter alia, the GAO on matters such as capital requirements applicable to U.S. intermediate holding companies of foreign banking and financial companies, as well as international coordination relating to the orderly resolution of systemically important financial companies under the Bankruptcy Code and applicable foreign law.

The extent to which provisions of the Act will have “extraterritorial effect” remains somewhat unclear. The Act’s capital standards and other enhanced prudential standards will clearly be applied to operations and activities of foreign banking and nonbank financial organizations that are conducted in the United States. In addition, however, enhanced prudential standards and other provisions may also be applied to operations of non-U.S. organizations which are deemed to have a direct connection with financial activities in the U.S. or which are determined to have a significant impact on the U.S. financial markets, presumably subject to textual support for such extraterritorial applications in the relevant

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legislative language, as well as other principles enunciated in the U.S. Supreme Court's recent decision in *Morrison v. National Australia Bank Ltd.*, 561 U.S. ___, slip op. (June 24, 2010). In any event, broad consultation with foreign regulatory authorities on issues of extraterritorial effect will almost certainly be undertaken by the appropriate U.S. regulatory agencies.

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