

Dodd-Frank Wall Street Reform and Consumer Protection Act

From Enactment to Implementation

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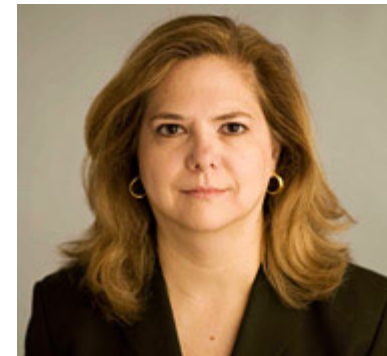
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Introduction



Dodd-Frank Wall Street Reform and Consumer Protection Act: Legislative Origins

- On July 21, 2010, President Barack Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act, the most sweeping financial reform legislation in over a generation.
- The bill was two years in gestation, and it took more than a year from when the Administration released a “white paper” on regulatory reform to when a bill reached the President’s desk.
- Nevertheless, the Dodd-Frank Act was the product of a highly unusual process; one destined to generate mistakes.
- The conference on the bill, while remarkably transparent, was more like a mark-up than a normal conference. *Conferees took more than 150 votes*, many, literally, on the fly.
 - Fewer than half as many votes were taken on the House and Senate floors, combined.
- The results are –
 1. More thorny issues were committed to regulatory discretion; and
 2. A technical corrections bill is more likely.



Dodd-Frank Wall Street Reform and Consumer Protection Act: From Enactment to Implementation

- In addition to the reforms Dodd-Frank implements directly, the Act provides hundreds of rulemaking provisions, which will be implemented over the next 18 months.
- Due to the breadth and complexity of the Act, the actual number of rulemaking provisions remains subject to debate.
 - SIFMA has indicated the Act has more than 250 rulemaking provisions. The Chamber of Commerce has placed the number at 530, with an additional 60 studies and 90 reports required.
- Regardless of the actual figure, as we move into the implementation phase of this legislation, one certainty is that companies will need to understand how Dodd-Frank affects their business.
- The rulemaking process has started already. Agencies are taking meetings, soliciting comments, and coordinating efforts.



Capital Requirements for Banks, Holding Companies,
and Supervised Nonbank Financial Companies



Dodd-Frank Title I: Financial Stability Capital Requirements

- **Prudential Capital Standards:** Fed must establish prudential standards for “Title I Companies”.
 - Large, interconnected financial institutions.
 - Standards must include risk-based capital requirements and may include a contingent capital requirement.
 - “More stringent and increasingly stringent” and “tailored”.
- **Capital Restoration in Early Remediation:** Fed must prescribe regulations for early remediation of Title I Companies experiencing increased financial distress.
 - Define the financial condition of the company in terms of regulatory capital.
 - Establish increasingly stringent limits on capital distributions.
 - Provide for a capital restoration plan and capital raising requirements.



Dodd-Frank Title I: Financial Stability

Contingent Capital

- **Requirements:** Fed may, for Title I Companies, adopt contingent capital requirements designed to “maintain a minimum amount of long-term hybrid debt that is convertible to equity in times of financial stress”.
 - Fed must consider the Council’s study and report, an appropriate transition period, all the considerations going into prescribing tailored prudential standards, the entity’s capital requirements, and any other factors the Fed deems appropriate.
- **Study:** The Council must conduct a study, and report to Congress, within 2 years of enactment, on the feasibility, benefits, costs and structure of a contingent capital requirement on Title I Companies.
 - Must evaluate the degree such requirements would enhance safety and soundness, promote U.S. financial stability, and reduce risks to U.S. taxpayers.
 - Must also evaluate the characteristics and amounts of contingent capital to be required, analyze potential prudential standards that should be used to determine whether contingent capital would be converted to equity in times of financial stress, evaluate the cost to companies and the effects on the financial markets of requiring contingent capital, and evaluate the effects on international competitiveness of companies subject to the requirement.



Dodd-Frank Title I: Financial Stability

Minimum Capital Requirements (“Collins Amendment”)

- Federal banking agencies must establish minimum leverage capital and risk-based capital requirements for insured depository institutions, bank holding companies and savings and loan holding companies.
 - “Leverage capital” means the ratio of tier 1 capital to total average assets.
 - May “not be less than” the minimum capital standards for banks as of enactment.
 - Applies prompt corrective action regulations - only instruments included in calculating tier 1 capital adequacy for banks may be used in holding company capital adequacy calculations.
 - Trust preferred securities excluded from tier 1 capital.
- Applied without regard to total consolidated asset size or foreign financial exposure.
- For savings and loan holding companies the provision takes effect 5 years after enactment, except for a 3-year phase in for previously issued debt and equity.
- A holding company with less than \$15 billion in consolidated assets on December 31, 2009 and any mutual holding company as of May 19, 2010 is not required to implement the capital deductions applied to large companies.
- Does not apply to instruments issued to the U.S. government under the Emergency Economic Stabilization Act of 2008, or to any Federal home loan bank, or a bank holding company with consolidated assets of less than \$150 million.



Dodd-Frank Title I: Financial Stability

Hybrid Capital Studies

- **Study of Hybrid Capital Instruments.** Comptroller General, with the Fed, Comptroller of the Currency, and FDIC, must conduct a study of the use of hybrid capital instruments as a component of tier 1 capital for banking institutions and bank holding companies.
 - Study must consider current use, difference between the components of capital permitted for insured depository institutions and for companies that control depositories, the benefits and risks of allowing such instruments to comply with tier 1 capital requirements, the economic impact of a prohibition, the consequences of disqualifying trust preferred instruments, international competitive implications, the impact on the cost and availability of credit in the U.S., the availability of capital for financial institutions with less than \$10 billion in total assets, and any other relevant factors.
 - A report on the study must be submitted to Congress within 18 months of enactment.
- **Study of Foreign Bank IHC Capital Requirements.** Comptroller General, in consultation with the Secretary of the Treasury, the Fed, Comptroller, and FDIC, must conduct a study of capital applicable to U.S. intermediate holding company subsidiaries of foreign companies that are bank holding companies and savings and loan holding companies.



Dodd-Frank Title VI: Financial Stability

Capital Requirements

- **Holding Companies Well Capitalized and Managed:** Bank holding companies and savings and loan holding companies engaged in financial activities must be well capitalized and well managed — in addition to the present requirement that insured depository institutions in a financial holding company be well capitalized and well managed.
 - Extends the well capitalized/well managed requirement from the depository subsidiary to the holding company level.
- **Countercyclical Capital Standards:** Fed may establish capital standards by regulation and order and must make such standards countercyclical so the amount of capital required increases in times of economic expansion and decreases in times of economic contraction.
 - Countercyclicality also imposed on capital standards applied to insured depository institutions.



Living Wills: The Emerging Coordinated Cross-Border Approach to Rapid Resolution Plans



Dodd-Frank Title I: Living Wills

International Support

- *British Idea.* Requiring “too big to fail” financial institutions to prepare and maintain rapid resolution plans originated with United Kingdom regulators.
- *U.S. Regulators Join the Call.* By late September 2009 senior U.S. Treasury officials initiated a series of public statements promoting the idea of requiring “living wills”.
- *Basel Committee.* In March 2010 the *Basel Committee’s Cross-border Bank Resolution Group* issued ten recommendations relating to the resolution of financial institutions. These go well beyond information sharing and include providing national authorities tools to ensure orderly resolutions, including power to create bridge financial institutions, transfer assets, liabilities and business operations, and resolve claims.
- *Memorandum of Understanding.* On January 10, 2010 the FDIC and Bank of England signed an MOU promising greater cooperation when acting as resolution authorities, including consulting and supporting the development of recovery and resolution plans.

Dodd-Frank Title I: Living Wills

British Approach

- **Pilot Program:** In November 2009 the FSA launched a pilot program.
- **Plans:** FSA has proposed requiring two types of “living will” plans:
 - *Recovery Plans:*
 - Must set out the firm’s plans for how it would respond to severe stress.
 - Demonstrate the extent to which recovery could be supported by management actions to reduce the risks to which the business is exposed (‘de-risking’).
 - Must have a ‘contagion control plan’.
 - Address facilitating the timely distribution of client assets from a failed or failing firm.
 - *Resolution Plans:*
 - In contrast to recovery plans, resolution plans would not focus on the steps management of the firm would take. Rather, if a firm moves into resolution it will be for the authorities to determine the appropriate course of action, within a legislative framework.
 - Authorities must be assured that firms are able to provide – in an appropriate, and potentially very short, timescale – the data necessary both to assess the resolution options and to execute the authorities’ chosen strategy.
 - Firms must be able to explain the relationships between the different entities within a group, in each case explaining the basis of the relationship (for example, legal status, financial, staffing, premises) and contingency arrangements in case of interruption to that relationship.



Dodd-Frank Title I: Living Wills FDIC Proposal

- On May 11, 2010 the FDIC proposed to subject approximately 40 of the largest U.S. depository institutions to a “living will” requirement.
- Rule would apply to depository banks with more than \$10 billion in assets that are part of a larger holding company with more than \$100 billion in assets.
- FDIC stated the plan would dovetail with “living will” requirements in proposed enhanced financial regulations.

Dodd-Frank Title I: Living Wills

Dodd-Frank Approach to Living Wills

- **Resolution Plans:** The Fed must require that all Title I Companies “periodically” prepare orderly resolution plans, or “living wills,” to plan for the event of material financial distress or failure. Each plan must include:
 - Information on the manner and extent to which any insured depository institution affiliated with the company is adequately protected from risks arising from the activities of any nonbank subsidiaries of the company;
 - Full descriptions of the ownership structure, assets, liabilities, and contractual obligations of the company;
 - Identification of the cross-guarantees tied to different securities; identification of major counterparties;
 - A process for determining to whom the collateral of the company is pledged; and
 - Any other information the Fed and FDIC jointly require by rule or order.
- **Credit Exposure Reports:** Fed must also require that each Title I Company submit a periodic report to the Fed, Council and FDIC on the nature and extent to which the company has credit exposure to other significant nonbank financial companies and significant bank holding companies and the nature and extent to which other significant nonbank financial companies and bank holding companies have credit exposure to it.
- **Regulations:** The Fed and FDIC must issue regulations implementing the “living will” provisions within 18 months of enactment. However, the statute does not specify when resolution plans must be first submitted.



Dodd-Frank Title I: Living Wills

Review of Plans and Divestiture

- **Review:** Each orderly resolution plan and credit exposure report will be reviewed by the Fed and FDIC.
- **Revise:** If they jointly determine that a resolution plan of a Title I Company is not credible or would not facilitate an orderly resolution of the company in bankruptcy, then the Fed and FDIC must notify the company of the deficiencies and the company must revise and resubmit the plan.
- **Resubmit:** If a re-submitted plan is not viewed as credible by these agencies, they may impose requirements or restrictions on capital, leverage, liquidity, growth, or operations .
- **Divestiture:** The Fed and FDIC, in consultation with the Council, may jointly direct a Title I Company to divest assets or operations in order to facilitate an orderly resolution in the event of failure if the Fed and FDIC have jointly imposed more stringent requirements on the company and the company has failed, within 2 years, to resubmit a resolution plan with the required revisions.




Implementation Issues Arising from Resolution Authority Provisions



Dodd-Frank Title II: Orderly Liquidation Authority – Overview & Highlights

Highlights

- New Orderly Liquidation Authority will displace the Bankruptcy Code in the resolution of large, systemically significant financial companies when their collapse threatens the U.S. economy.
- Claims are determined by administrative review process, with judicial review available after administrative review.
- An Orderly Liquidation Fund is capitalized upon the initiation of the Liquidation Authority.



Dodd-Frank Title II: New Orderly Liquidation Authority

- Orderly Liquidation Authority will apply to a “financial company,” which includes:
 - a bank holding company;
 - a nonbank financial company subject to heightened prudential supervision by the Fed;
 - a company predominantly engaged in activities that are financial in nature or incidental thereto for purposes of Section 4(k) of the Bank Holding Company Act (the “BHCA”);
or
 - any subsidiary of the above that is predominantly engaged in activities that are financial in nature or incidental thereto for purposes of Section 4(k) of the BHCA (other than an insured depository institution or insurance company).
 - This includes brokers or dealers.
- No company will be deemed to be engaged in activities that are financial in nature or incidental thereto for purposes of section 4(k) of the BHCA if the consolidated revenues of such activities are less than 85% of the total consolidated revenues of the company.
 - What will constitute activities that are “financial in nature or incidental thereto”?



Dodd-Frank Title II: New Orderly Liquidation Authority (cont'd)

- Displaces the Bankruptcy Code for the liquidation of large, systemically significant financial companies when their collapse threatens the US economy.
- FDIC (or the SEC if the company is a broker-dealer, or the Federal Insurance Office if the company or its largest subsidiary is an insurance company) will become the receiver of the company.
- Receiver will be appointed upon financial company's approval or judicial order from the U.S. District Court for the District of Columbia.



Dodd-Frank Title II: Claims Process

- Claims are determined initially through administrative review by the FDIC.
- Secured creditors are secured to the “fair market value” of their collateral.
- Similarly situated creditors are treated similarly unless the receiver allows for unequal treatment.
- Maximum liability of the receiver is set at the amount a creditor would receive if the entire company were liquidated under chapter 7 of the Code or any state insolvency law and if the FDIC had not been appointed as receiver of the company.
- QFCs are stayed until 5:00 pm of the next business day. QFCs can be transferred to a third party at this time, at which point the counterparty cannot terminate the QFC.
- Receiver can avoid fraudulent or preferential transfers.
- Creditors receive setoff rights, but may sell or transfer any asset free and clear of any setoffs. Creditors receive an unsecured claim for their setoff.
- The FDIC can recover compensation from senior executives and directors.



Dodd-Frank Title II: Claims Process (cont'd)

- Rulemaking Challenges:
 - How and when is fair market value measured for secured creditors?
 - How and when is the maximum liability of the receiver to a claimant measured?
 - Will the FDIC set rules for the unequal treatment of similarly situated creditors?
 - What type of “compensation” can the FDIC recover from executives and directors?
What other rules might the FDIC place on recovery of executive compensation?
 - Will agency-issued rules and regulations for Title II be similar to current insolvency law?
 - How will the FDIC calculate interest rates for post-insolvency interest?
 - What is the standard for proving a claim?



Dodd-Frank Title II: Orderly Liquidation Fund

- Title II establishes the Orderly Liquidation Fund (the “Fund”).
- Maximum Obligation Limitation: The Fund is capitalized after a financial company is placed into the Liquidation Authority through FDIC-backed debt obligations sold to the Treasury.
 - First 30 days: capitalized to an amount equal to 10 percent of the total consolidated assets of the covered financial company.
 - After 30 days: capitalized to the amount equal to 90 percent of the total consolidated assets of each company that are available for repayment.
- Risk-based assessments imposed *ex post* on companies to repay any amounts expended from the Fund.
 - Assessments imposed on (in the following order):
 - Companies that received additional payments and preferential treatment in the liquidation process.
 - Nonbank financial companies supervised by the Fed, and bank holding companies and financial companies with over \$50 billion in total consolidated assets.
- Rulemaking Challenges:
 - How will the FDIC calculate the “maximum obligation limitation”?
 - Who will be charged risk-based assessments and how will assessments be charged?



Registration of Private Fund Advisers

Dodd-Frank Title IV: Private Fund Investment Advisers Registration Act – Registration

- **Advisers Act Section 203(b)(3) exemption for advisers with fewer than 15 clients is no longer available to advisers to private funds (*i.e.*, hedge funds, PE funds, and real estate funds).**
 - A “private fund” is an issuer that would be an investment company, except for Section 3(c)(1) or 3(c)(7).
 - Exception from registration, but not reporting or books and records requirements, for advisers to “venture capital funds,” as defined by the SEC.
 - Section 202(a)(11)(G) exempts “family offices” from the definition of investment adviser, but not from the antifraud provisions of Section 206.
- **Limited exemption for foreign private advisers with fewer than 15 U.S. clients and investors**
 - Aggregate AUM attributable to U.S. clients and U.S. investors in private funds advised by the investment adviser of less than \$25 million, or such higher amount as the SEC determines.
 - No U.S. place of business.
 - No holding itself out to the public in the U.S. as an investment adviser.
- **Timing: July 21, 2011.**



Dodd-Frank Title IV: Private Fund Investment Advisers Registration Act – Registration (cont'd)

- The threshold for registration with the SEC as an investment adviser increased from \$25 million AUM to \$100 million AUM.
- Mid-sized investment advisers (*i.e.*, with AUM between \$100 million and \$150 million) may be exempted from SEC registration, but can still be subject to recordkeeping and reporting requirements.
- The intrastate exemption no longer applies to investment advisers to private funds.
- The SEC and CFTC are required to jointly promulgate reporting requirements for investment advisers that are dually-registered with both agencies.



Dodd-Frank Title IV: Registration Reporting, Recording and Exam Requirements

- The records and reports that an investment adviser is required to maintain and that are subject to SEC inspection include, for each private fund, a description of:
 - the amount of AUM and use of leverage, including off-balance sheet leverage;
 - counterparty credit risk exposure;
 - trading and investment positions;
 - valuation policies and practices of the fund;
 - types of assets held;
 - side arrangements or side letters whereby certain investors in the fund obtain more favorable rights or entitlements than other investors;
 - trading practices; and
 - such other information as the SEC determines is necessary in the public interest and for the protection of investors or, in consultation with the Council, for systemic risk assessment.
- The SEC must adopt rules specifying the records that private fund advisers must make and reports they must file, and the retention period for such records.



Dodd-Frank Title IV: Registration Reporting, Recording and Exam Requirements (cont'd)

- Records of private funds that are maintained by a registered investment adviser are deemed the records and reports of the investment adviser, and are subject to periodic, special and other SEC examination.
- The SEC must provide such reports or records to the Council as are needed to assess the systemic risk of the private fund, including the identity of an adviser's clients.
 - Information provided to Congress, the Council, other regulators and SROs; and is subject to the same level of confidentiality as the SEC.
 - “Proprietary information” (*i.e.*, sensitive, non-public information regarding an adviser's investment or trading strategies, analytical or research methodologies, trading data, computer hardware or software containing intellectual property and other information the SEC determines is proprietary) that the SEC ascertains from any filed report is protected to the same extent as if ascertained during an exam.



The Revised Definition of “Accredited Investor”



Dodd-Frank Title IV: Accredited Investor Standard

- The value of an investor's primary residence may no longer be included in determining net worth for an accredited investor under Securities Act Rules 215 and 501(a)(5).
- Pending SEC rulemaking to adjust the accredited investor standard, the staff has advised that when determining net worth:
 - the related amount of indebtedness secured by a primary residence up to its fair market value may be excluded, in addition to the market value of the house, and
 - any indebtedness secured by the residence in excess of the value of the home should be considered a liability and deducted from the investor's net worth.
- *Compliance and Disclosure Interpretations*, Question 179.01 (added July 23, 2010).



Implications of the Volcker Rule

Dodd-Frank Title VI: Volcker Rule

Overview & Highlights

- Named after former Fed Chairman Paul Volcker
- Goal is to separate certain risk activities from the federal bank subsidy
 - Proprietary trading
 - Private fund investing
- Final rule follows approach of the Merkley-Levin Amendment in the Senate
- Intended to do three things:
 - (1) Prohibit high risk activities by banks;
 - (2) Limit the risk of such activities at systemically significant nonbank financial companies; and
 - (3) Prohibit material conflicts of interest in asset-backed securities.
- Impacts two classes of companies:
 - (1) “Banking entities” prohibited from engaging in risk activities; and
 - (2) Regulators must apply quantitative limits and capital requirements to nonbank financial companies supervised by the Fed engaged in these activities.
- “Banking entities” include any entity that controls a depository institution (and its affiliates).
 - A company that is both a “banking entity” and a “supervised” nonbank financial company is subject to the outright prohibition applicable to banking entities.
- Supervised nonbank financial companies (“NBFCs”) include systemically significant nonbank financial companies designated for Fed supervision and former bank holding companies with over \$50Bn in assets that become NBFCs.
 - Capital charges and quantitative limits increase with the size, leverage, interconnectedness, and systemic importance of the activities.

Dodd-Frank Title VI: Volcker Rule

Prohibited Activities

- Proprietary Trading:
 - Banking entities prohibited from engaging in proprietary trading.
 - Fed must set capital requirements and quantitative limits on supervised nonbank financial company that do so.
 - Prop Trading means engaging as a principal for the trading account of the entity in any transaction to buy or sell a security, derivative, futures contract, or option that regulators by rule determine should be covered.
 - “Trading Account” means an account used to take positions in securities for the purpose of selling in the near term (or with intent to sell to profit from short-term price movements).
- Fund Investing:
 - Banking entities prohibited from holding an equity, partnership, or other ownership interest in, or “sponsoring”, a hedge or private equity fund.
 - Fed must set capital requirements and quantitative limits on the activities of supervised nonbank financial companies related to such funds.
 - PE and Hedge Funds defined to mean issuers that would be investment companies under the Investment Company Act but for Sections 3(c)(1) and 3(c)(7).
 - Venture Capital Funds within definition but comments by key senators suggest will be excluded by rule.
 - “Sponsoring” includes serving as a general partner, managing member, or trustee; controlling a majority of the directors, trustees or management; or sharing a name with the fund.
 - Not intended to prohibit investment in subsidiaries or JVs that hold investments but rather to prohibit firms from investing in traditional PE and hedge funds, according to Reps. Himes and Frank.

Dodd-Frank Title VI: Volcker Rule

Permitted Activities

- Exemptions from prohibitions, restrictions and limitations:
 - “Permitted activities” include investing in obligations of the United States and GSEs such as Fannie Mae and Freddie Mac, investing in small business investment companies, trading by insurance companies, engaging in market making “related” activities, trading for risk mitigation, trading for customers, and sponsoring a hedge or PE fund for sale that entails only a *de minimis* investment.
 - “*De minimis*” exception requires:
 - That the fund be organized and offered only in connection with the provision of *bona fide* trust, fiduciary or investment advisory services to customers of the banking entity.
 - Reducing ownership in any single fund to 3% within a transition period of one to three years.
 - That the aggregate investment in all funds be “immaterial to the banking entity”, which will be defined by rule but may by statute be no more than 3% of the banking entity’s tier 1 capital.
- Broad regulatory discretion:
 - Federal banking agencies, the SEC, and CFTC can impose additional capital requirements and quantitative limits (and diversification requirements) on fund ownership and proprietary trading even if the activities are “permitted” with regard to both banking entities and supervised nonbank financial companies.
 - Power to grant additional exemptions also broad.
- Affiliate transaction rules:
 - No banking entity that serves as the investment manager, advisor, or sponsor of a fund or that organizes a fund may enter into a covered transaction with the fund.
- Impact of Volcker will remain unclear until regulations are written, terms more clearly defined, and exceptions considered and granted.



Dodd-Frank Title VI: Volcker Rule

Timing and ABS

- “Effective date” for Volcker is earlier of 12 months after issuance of final rules or 2 years after enactment
 - Council has 6 months to study and recommend.
 - Fed has 9 months after study to adopt final rules.
 - Divestiture required within 2 years of effective date (extendable for 3 additional years)
 - For illiquid funds Fed can grant a single extension of up to 5 years.
- *ABS*. Section 621, also based on language from Senators Merkley and Levin, prohibits firms that package and sell asset-backed securities (including synthetic ABS) from engaging in transactions that result in material conflicts of interests.



How the Derivatives Provisions in Title VII
Are Likely to be Applied to Swap Dealers,
Major Swap Participants, and End-Users



Dodd-Frank Title VII: Wall Street Transparency and Accountability – Overview & Highlights

Highlights

- All standardized swaps (and perhaps more) must be cleared and exchange-traded.
- End users are exempt from the clearing requirement but only if (a) they are not “financial entities,” (b) they are not “major swap participants,” (c) they use swaps to hedge commercial risk, and (d) they can demonstrate how they meet their financial obligations associated with entering non-cleared swaps.
- The prudential banking regulators, the CFTC, and the SEC will set margin requirements for uncleared swaps and capital requirements on major swap participants and swap dealers.
- Though margin and capital requirements will be imposed on swap dealers, and not their end-user counterparties, it is understood that these additional costs will be passed on to end-users.
- Banks must spin off “riskier” swaps dealing activities but can still conduct such activities through separately capitalized affiliates.



Dodd-Frank Title VII Rulemaking Provisions: Definitions

Required Definitions

- CFTC and SEC are required to engage in joint rulemaking and to consult the Board of Governors when crafting definitions for key terms, such as:
 - “Swap Dealer” & “Security-Based Swap Dealer”
 - “Major Swap Participant” & “Major Security-Based Swaps Participant”
 - “Eligible Contract Participant”

Context / Significance of Definitions

- CFTC / SEC definitions are critical because they will determine which entities are covered and which entities are exempt from new rules.
 - Definition of “major swap participant” (“MSP”) will determine the scope of the end-user definition.
 - MSP definition itself depends on definitions of “substantial position”, “substantial counterparty exposure”, and “commercial risk”.
 - “Commercial risk” definition is also key to end-user exemption from clearing requirements.
- Not certain extent to which terms will be defined jointly by CFTC / SEC.

Dodd-Frank Title VII Rulemaking Provisions: Clearing / Capital & Margin Requirements

Clearing

- CFTC / SEC are required to establish respective frameworks for swaps and security-based swaps (“SB swaps”) clearing. Frameworks will include:
 - Creating a process to determine what swaps/groups of swaps must be cleared;
 - Creating an approval process for swaps that a derivatives clearing organization (“DCO”) / clearing agency plans to clear;
 - Establishing a review process of DCO / clearing agency swap clearing;
 - Preventing evasion of mandatory clearing; and
 - Creating transitional reporting rules for swaps entered into before or after enactment.

Capital & Margin

- CFTC / SEC / Prudential Banking Regulators are required to establish capital and margin requirements for swap dealers and MSPs.
- Capital and margin requirements to be set to “help ensure safety and soundness” of swap dealer or MSP and must “be appropriate for the risk associated with *the non-cleared swaps*”.
- Must determine when non-cash collateral will be permitted.

Dodd-Frank Title VII Rulemaking Provisions: Reporting & Recordkeeping / Registration Requirements

Reporting & Recordkeeping

- CFTC is required to establish rules providing for the public reporting of swaps data; SEC is authorized (but not required) to establish rules providing for the public reporting of security-based swaps data.
 - Real-time reporting to be required even for exempt swaps.
- CFTC / SEC are required to establish rules on reporting and recordkeeping, daily trading records, business conduct standards, documentation standards, and duties – and on reporting of “transactions and positions and financial condition” of SD or MSP.
- CFTC / SEC are required to establish data standards for swaps / SB swaps, and rules for data collection and maintenance and duties for swap data repositories.
- CFTC / SEC are required to promulgate respective interim final rules for the reporting of outstanding swaps / SB swaps entered into before enactment of the bill.

Registration

- CFTC / SEC are required to provide for rules for the registration of swaps dealers and MSPs.
- CFTC / SEC cannot prescribe prudential requirements on swap dealers and MSPs that have prudential regulators.



Dodd-Frank Title VII Rulemaking Provisions: Other Key Provisions

Position Limits

- CFTC is required to set limits on the size of positions in any swap, other than bona fide hedge positions, that may be held by any person with respect to contracts of sale for future delivery or with respect to options on the contracts or commodities.
- SEC is required to establish limits on the size of positions in any SB swap that may be held by any person.

Exempt FOREX Transactions

- Treasury may determine that either foreign exchange forwards or foreign exchange swaps, or both, should not be regulated as swaps.
- Onerous standards make such a determination unlikely.

Conflict of Interest/Business Conduct Standards

- CFTC / SEC are required to adopt rules, respectively to mitigate the potential conflict of interest of a systemically important entity, swap dealer / SB swap dealer, or an MSP / MSBSP having an ownership stake in a DCO / swap exchange facility.
 - Rules may include numerical limits on the control of, or the voting rights with respect to, DCOs / swap exchange facilities.
- CFTC / SEC also to establish business conduct standards applicable to swap dealers and MSPs.
 - Standards to include various duties with respect to counterparties.
 - Special rules to apply to swap dealers acting as advisors.




Standard of Care for Broker-Dealers and Investment Advisers



Dodd-Frank Title IX: The Investor Protection and Securities Reform Act of 2010 – Standard of Care

- Within 6 months of enactment, the SEC must report to the Senate Banking and House Financial Services Committees on its findings and recommendations relating to the standards of care for broker-dealers, investments advisers and their associated persons when providing personalized investment advice and recommendations about securities to their respective “retail customers.”
 - A “retail customer” is a natural person, or his or her legal representative, who (a) receives personalized investment advice about securities from a broker, dealer, or investment adviser, and (b) uses such advice primarily for personal, family, or household purposes.
- *See* Release No. 34-62577 (July 27, 2010) requesting comments on or before August 30, 2010.



Dodd-Frank Title IX: Factors to be Considered by the SEC

1. The effectiveness of, and any gaps or overlaps in, existing federal and state legal and regulatory standards of care;
2. SEC, state and FINRA regulatory, examination and enforcement resources;
3. Substantive differences in regulation;
4. Specific instances in which regulation and oversight of advisers or broker-dealers provides greater protection to retail customers;
5. The potential impact on retail customers, including access to products and services and the availability of personalized investment advice and recommendations, if the Advisers Act standard of care and other requirements are imposed on broker-dealers;
6. The potential added costs and expenses for retail customers, broker-dealers, investment advisers and regulators resulting from changes to the duty of care, including elimination of the broker exception from the Advisers Act definition of “investment adviser;”
7. The varying level of services provided to retail customers by and the varying scope and terms of retail customer relationships with broker-dealers, investment advisers and their associated persons;
8. Retail customer understanding of or confusion about differences in standards of care and the quality of advice received; and
9. Any other consideration the SEC considers necessary and appropriate.



Dodd-Frank Title IX: Rulemaking Authority

- Exchange Act Section 15(k) authorizes the SEC to promulgate rules applying the standard of care applicable to investment advisers under Section 211 of the Advisers Act to broker-dealers when providing personalized investment advice about securities to retail customers or such other customers as the SEC specifies by rule.
 - A broker-dealer’s receipt of commissions or other standard compensation for securities will not in and of itself be considered a violation of the standard of care.
 - No continuing duty of care or loyalty to a customer after providing personalized investment advice.
 - The sale of only proprietary or other limited range of products will not, in and or itself, be considered a violation of any applicable standard of care, although the SEC may require some form of notice to or consent by the customer.
- Advisers Act Section 211(g) authorizes the SEC to promulgate rules providing that a broker-dealer or investment adviser must act in the best interest of its customer, and without regard to its own financial or other interests, when providing personalized investment advice about securities to a retail customer or such other customers as the SEC specifies.
- The SEC may not define “customer” to include an investor in a private fund managed by an investment adviser where the private fund has entered into an advisory contract with the adviser.



Dodd-Frank Title IX: Disclosure and Sales Practices Requirements

- The SEC is required to facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers-dealers and investment advisers, including any material conflicts of interest.
- Exchange Act Section 15(n) authorizes the SEC to issue rules designating documents or information that broker-dealers must provide retail investors before they purchase an investment product or service. Any required disclosures will need to be in a summary format and include clear and concise information about investment objectives, strategies, costs and risks; and any compensation or other financial incentive received by a broker, dealer, or other intermediary in connection with the purchase of retail investment products.
- The SEC must also examine, and where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes that it deems contrary to the public interest and protection of investors.

Dodd-Frank Title IX:

Additional Related Studies

1. **Investment Adviser Examinations**

- The SEC must conduct a study and report on the need for enhanced examination and enforcement resources for investment advisers, including an SRO and any legislative or regulatory steps that may be necessary.
- Deadline: January 2011

2. **Financial Literacy Among Investors**

- The SEC must conduct a study and report on retail investors' financial literacy and make recommendations for improving the timing, content and form of disclosures, including transparency of expenses and conflicts of interests.
- Deadline: July 2012

3. **Mutual Fund Advertising**

- The Comptroller must conduct a study and report on current and proposed requirements and current market practices, and make recommendations relating to mutual fund advertising.
- Deadline: January 2012

4. **Possible Extension of Global Research Settlement**



- The Comptroller must conduct a study and report on potential conflicts of interests that exist between investment banking and securities research analyst functions within the same firm, and make recommendations to Congress designed to protect investors from such conflicts.
- Deadline: January 2012

5. **Improved Investor Access to Information on Investment Advisers and Broker-Dealers**

- The SEC must conduct a study and recommend improvements for investor access to information, including disciplinary history, on the CRD and IARD systems about current and previously registered broker-dealers, investment advisers and their associated persons.
- Deadlines: Report: January 2011; Implementation: January 2012.

6. **Use of Financial Designations, including “Financial Planners”**

- The Comptroller must conduct a study and report on the effectiveness of state and federal regulations relating to the use of financial designations, and make recommendations for the appropriate regulation of financial planners and others who provide similar services relating to the sale of insurance and securities.
- Deadline: January 2012.



New “Whistleblower” Rewards and Protections &
Expanded SEC Authority to Impose Fines and Sanctions



Dodd-Frank Title IX: Investor Protections and Improvements to the Regulation of Securities – Overview & Highlights

Highlights

Whistleblower Rewards and Protections

- SEC and CFTC are required to adopt rules requiring the payment of 10 to 30 percent of amounts recovered in enforcement actions as rewards to whistleblowers.
- Expands protections for whistleblowers alleging retaliatory job actions.

Increased SEC Civil Fine Authority

- Allows SEC to impose fines on officers and employees of public companies in SEC administrative actions.
- Expressly states that “reckless” conduct is a basis for secondary liability
- Extends anti-fraud jurisdiction to conduct occurring overseas
- Increases collateral consequences from an enforcement action
- Imposes deadlines on the completion of enforcement investigations and examinations



Dodd-Frank Title IX: Whistleblower Rewards and Protections

Whistleblower Rewards and Protections

- Whistleblower who provides original information to SEC or CFTC leading to a recovery greater than \$1 million may receive not less than 10% and not more than 30% of the recovered amount as a reward.
- Information may be provided anonymously and the Act contains protections against disclosure of whistleblower's identity.
- Whistleblowers do not include persons employed by auditors, regulators or law enforcement agencies or persons convicted of crimes related to the complaint.
- Dodd-Frank expands prior Sarbanes-Oxley protections by creating a new private right of action in federal court, extending the statute of limitations, and permitting recovery of two times back pay and other relief and including employees of subsidiaries within the scope of protection.
- Rewards and protections create incentives for persons to provide "tips" and leads to regulators.
- Implementing rulemaking required within 270 days.



Dodd-Frank Title IX: Increased SEC Authority

Increased SEC Authority

- **Civil penalty authority in SEC administrative proceedings.**
 - Prior law limited SEC authority to impose fines to cases involving brokers, dealers, investment advisers.
 - Dodd-Frank extends this authority to any person, including officers and employees of public companies, accountants, and persons associated with auditors.
 - SEC administrative proceedings are more summary than federal district court civil litigation: an administrative law judge is the finder of fact, there is no discovery, no right to a jury trial, more limited standard of appellate review.



Dodd-Frank Title IX: Expanded Secondary Liability

Expanded Secondary Liability

- Expressly states that “reckless” conduct is sufficient proof for “aiding and abetting” liability, changing language adopted by Congress in 1995.
 - Effect is to lower standard of liability for individuals charged with reporting, internal control and other violations where a company has primary liability.
- Expands the scope of “controlling person” liability.



Dodd-Frank Title IX: Trans-national Provisions and Other Significant Provisions

Trans-National Provisions

- Permits SEC and DOJ to assert jurisdiction over conduct occurring overseas with a foreseeable substantial effect in the United States.
- Makes foreign private accounting firms subject to jurisdiction of the SEC and PCAOB for the purpose of producing audit working papers.
- Amends U.S. law to give greater confidentiality to work papers of foreign private accounting firms so as to facilitate PCAOB inspections and SEC investigations.

Other Significant Provisions

- **Collateral consequences.** Dodd-Frank permits the SEC to bar or limit the association of persons across the securities industry, including brokers, investment advisers, investment companies and other regulated enterprises.
- **Time deadlines.** The SEC will be required to either file suit or close an investigation within 180 days of a “Wells” notification. Examiners must provide deficiency letters within 180 days of the completion of an examination or inspection.




Executive Compensation and Corporate Governance Provisions,
Including Say-on-Pay Votes Required Beginning in 2011




Dodd-Frank Title IX: Executive Compensation Provisions

- Say-on-Pay:
 - Non-binding vote on NEO compensation every one, two or three years
 - Separate vote at least every six years to determine how often say-on-pay vote will occur
 - Effective for shareholder meetings occurring on or after January 21, 2011
- Disclosure and Non-Binding Vote on Golden Parachute Compensation:
 - Disclosure of NEO compensation that is based on or related to a merger, sale of assets or similar transaction
 - Required in proxy materials for vote on transaction
 - Non-binding vote required unless previously subject to say-on-pay vote
- Broker Voting: limiting broker discretionary voting on director elections, executive compensation and other “significant matters”
- Compensation Committee Independence / Compensation Consultants and Advisors



Dodd-Frank Title IX: Executive Compensation Provisions (cont'd)

- Mandatory Clawback: requires adoption of clawback policy to recoup payments of incentive compensation to current and former executive officers:
 - If accounting restatement required based on erroneous data due to material noncompliance with financial reporting requirements; and
 - Regardless of culpability.
- Disclosure of Relationship of Pay to Financial Performance
- Disclosure of Internal Pay Ratio
- Policies on Employee, Executive Officer and Director Hedging
- Executive Compensation Disclosures and Prohibitions for Regulated Financial Institutions



Dodd-Frank Title IX: Corporate Governance and Other Provisions

- Proxy Access: SEC may, but is not required to, adopt rules regarding shareholder proxy access for nomination of directors
- Disclosure of Board Leadership Structures: SEC required to adopt rules within 180 days requiring disclosure of company's decision regarding separation (or not) of chairman and CEO roles.
 - Unlikely to result in significant changes from recently adopted SEC rules on this subject
- Regulation FD and disclosure of credit ratings
- Beneficial ownership and short-swing profit reporting
- Title XV: Extractive industries, mine safety and “conflict minerals” disclosures



Dodd-Frank Title IX: What Does the Act Mean for Corporate Governance and Executive Compensation?

- Greater role for shareholders
- Tilts the balance to activist investors' influence
- Increases influence of proxy advisory firms
- Pressure on compensation committees to use independent advisors
- Increased scrutiny by activist investors and the media regarding design and amount of compensation
- Pressure on companies and compensation committees to choose appropriate performance metrics
- Will require year round shareholder engagement



Establishment of the Bureau of Consumer Financial Protection



Dodd-Frank Title X: Consumer Financial Protection Bureau Highlights & Overview

- Created by Title X of the Act to provide consumers with timely and comprehensible information about financial transactions and protect them from unfair or deceptive acts and practices.
- Further intended to ensure that markets for consumer financial products are fair, transparent, and competitive.
- Housed within the Federal Reserve, but safeguards protect against interference.
- Director will be appointed by the President and confirmed by the Senate for a 5-year term.
- Funded without imposing fee assessments on covered institutions.



Dodd-Frank Title X: Consumer Financial Protection Bureau

Scope of Bureau Authority

- Broad purview over any person that engages in offering or providing a consumer financial product or service.
 - Authority over providers of financial products or services offered primarily for personal, family, or household purposes.
 - No authority over credit extended directly by merchants, real estate brokerage activities, accountants or tax preparers, attorneys, employee benefit and compensation plans, or persons regulated by a state securities commission.
- Primary functions
 - Ensure that consumers are provided with timely and understandable information to make responsible decisions about financial transactions.
 - Protect consumers from unfair, deceptive, or abusive acts and practices and from discrimination.
 - Identify outdated, unnecessary, or unduly burdensome regulations
 - Ensure that markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation.
 - Supervise covered entities through reporting requirements and examinations.
 - Enforce federal consumer financial law, including the imposition of civil fines.
- Conflicts between the Bureau and any prudential regulator will be resolved by an appeal to a governing panel consisting of a representative from the Bureau, a representative of the prudential regulator, and a representative from the Federal Reserve, FDIC, NCUA, or OCC.



Dodd-Frank Title X: Consumer Financial Protection Bureau Rulemakings

- Due to the potentially broad nature of the Bureau's authority under the statutory provisions, the implementation of Title X through the Bureau's regulations will be critically important to its impact.
- Proposed rulemaking must consider the potential costs and benefits to consumers and covered persons.
- Bureau is to consult with prudential regulators and other appropriate federal agencies before proposing a rule and during the comment process.
- Financial Services Oversight Council may set aside Bureau's regulations based on safety and soundness concerns by two-thirds.



Dodd-Frank Title X: Consumer Financial Protection Bureau Preemption

- Replaces current regime (complete preemption) with conflict preemption.
 - Under existing regime, state laws that merely “touch upon” business of banking are preempted. Now only conflicting state laws are preempted.
 - State law not to considered to “conflict” if it is more protective than federal law.
 - Federal consumer financial protection law will be considered a floor rather than a ceiling.
- Deputizes state AGs to enforce federal consumer financial protection laws