

Dodd-Frank Wall Street Reform and Consumer Protection Act

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Introduction

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act into law (“Dodd-Frank” or the “Act”). At once Dodd-Frank was hailed by some as fulfillment of a promise, a promise to reform the financial system in order to promote financial stability and protect consumers from those that might again use their dreams to entice them into taking on obligations that then quickly overtake them. However, like many regulatory efforts, Dodd-Frank leaves a number of details to be resolved in the future, through the adoption of regulations or the exercise of discretion by those at the helm when the next crisis begins to build on the horizon. So in many ways, the enactment of Dodd-Frank fulfills a promise by making one. A promise that when the next economic boom shows signs of a bubble, regulators who see risk despite a flood of rewards will be empowered to act and, more importantly, will act prudently.

In the following pages, we have sought to highlight some of the more significant provisions of the Act. With this effort, we are not seeking to provide a compliance guide, but rather identify those sections that might warrant your attention as implementing regulations are developed and implementation deadlines approach. This is also one in a series of client advisories addressing Dodd-Frank and will be followed by a number of more narrowly focused advisories in the coming weeks and as implementing regulations bring clarity to this wide ranging piece of legislation.

Regulation of Systemic Risks

Large Systemically Important Companies and Activities

Dodd-Frank is a product of, and a response to, the instability in the financial services industry at the center of the recession. The immediate reaction to that instability was the Emergency Economic Stabilization Act of 2008 (“EESA”) and the Troubled Asset Relief Program (“TARP”). While what became more popularly known as “the bailout” helped stabilize a financial services industry in crisis, it provided no real prescription for ongoing stability. Enter the second, and hopefully more thoughtful, child of the financial crisis, Title I of Dodd-Frank, also known as the Financial Stability Act of 2010.

In an effort to achieve ongoing stability in the financial services industry, Title I of Dodd-Frank creates a powerful new regulatory authority, the Financial Stability Oversight Council (“FSOC”), and empowers it to identify risks to the financial stability of the United States, promote market discipline by eliminating the expectation that some institutions might be too big to fail and respond to emerging threats to the financial system. FSOC is authorized to fulfill its charge in two critical ways: first by identifying and regulating large, systemically important financial companies whose distress, failure or ongoing activities could pose a threat to the financial stability of the United States; and second by identifying and regulating activities and practices that could create or increase risk among bank holding companies, non-bank financial companies and financial markets in general.

At first blush, the reference to large, systemically important financial companies can be seen as a focus on the large Wall Street financial firms whose activities and practices are often cited as the source of the recent wave of financial instability. While this view may go a long way towards satisfying the public’s desire for a punitive response to Wall Street, FSOC’s authority is much broader than that. FSOC is authorized to recommend heightened prudential standards and regulations for bank holding companies with total assets of \$50 billion or more. As of March 31, 2010, this would include at least 36 bank holding companies. FSOC also has the authority to designate systemically important non-bank financial companies, subject them to supervision by the Federal Reserve and recommend prudential standards and regulations. In addition, all publicly traded bank holding companies with consolidated assets in excess of \$10 billion will be required to form risk committees and all financial companies with consolidated assets of at least \$10 billion will be required to perform annual stress tests. The Federal Reserve also has the authority to extend the stress test requirement to other bank holding companies and nonbank financial companies. Most broadly of all, FSOC, through the new Office of Financial Research, may impose reporting requirements on all bank holding companies and nonbank financial companies, with no restriction on their size.

If FSOC determines that financial distress at a non-bank financial company or the nature or size of such company or its activities could pose a threat to the financial stability of the United States, the company can be designated as systemically important. Taking into consideration the nature and size of its U.S. activities, FSOC may make the same determination with respect to a foreign non-bank financial company. In large part, however, the scope of this authority lies in the definition of non-bank financial company. A non-bank financial company is a company with 85% or more of its gross consolidated annual revenues derived from, or 85% or more of its consolidated assets related to, activities that are financial in nature as defined in section 4(k) of the Bank Holding Company Act of 1956. The activities that fall within this definition include, but are not limited to: (1) lending, exchanging, transferring, investing for others, or safeguarding

money or securities; (2) insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing; (3) providing financial, investment, or economic advisory services, including advising an investment company (as defined in section 3 of the Investment Company Act of 1940); (4) issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly; (5) underwriting, dealing in, or making a market in securities; and (6) engaging in any activity that the Federal Reserve has determined as of November 12, 1999, to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. This last category is in turn defined in regulations found in 12 CFR Part 225 and includes another 14 categories of activities. While most are activities normally associated with banking and financial services, a few are not, such as appraisal services, management consulting and counseling, community development activities and financial and economic data processing services. In addition, the anti-evasion provisions of the Act provide that FSOC may designate a company that is not otherwise a financial company for regulation by the Federal Reserve if it determines that the company is organized in such a way as to avoid the application of the Act and that it would otherwise meet the criteria for such designation.

FSOC's reach is also not limited to large systemically significant firms. FSOC is authorized to identify activities and practices that could create or increase risks of significant liquidity, credit or other problems among bank holding companies, non-bank financial companies and financial markets in general and then recommend heightened prudential standards and safeguards for those activities and practices. Such standards and safeguards may include prescribing the conduct of an activity or practice in specific ways (by limiting its scope or establishing capital or risk management requirements) or prohibiting an activity or practice all together. Once FSOC identifies such an activity or practice, its authority is not limited to banking companies of a certain size and our recent history provides an excellent example of how this power might be utilized. If FSOC identifies a developing real estate market bubble supported by sub-prime and other high risk real estate lending products along with high concentrations of real estate development loans in bank loan portfolios, it could act to reduce systemic risk and avert a financial crisis, including the failure of hundreds of small banks. It is at that point that the Financial Stability Act of 2010 will have the opportunity to earn its name.

Payment, Clearing, and Settlement Supervision

Dodd-Frank requires the Federal Reserve to establish uniform risk management and safety and soundness standards for systemically important financial market utilities ("FMUs") and financial institutions that are engaged in financial transactions such as money transfers and clearing and settlement of securities contracts, futures, swaps, foreign exchange, derivatives and repurchase agreements. FMUs are entities that manage or operate multilateral systems for clearing and settling such transactions among financial institutions. FSOC is responsible for identifying those FMUs and financial institutions whose payment, settlement and clearing activities are of systemic importance based on transaction volume and interdependencies with other market participants. Such designated FMUs and financial institutions will be examined for compliance with the Federal Reserve's risk management standards by their existing federal regulator, if any, or by the Federal Reserve if the entity has no other federal regulator. In exchange for subjecting FMUs to this enhanced supervision, designated FMUs become eligible to maintain accounts with the Federal Reserve and will have access to the Federal Reserve discount window and borrowing privileges in emergency circumstances.

Systemic Oversight of Insurance & Allocation of State Authority

Dodd-Frank establishes the Federal Insurance Office (“FIO”). For the most part, the FIO does not directly regulate or supervise insurance products or companies and instead operates at a more systemic level. Accordingly, FIO is charged with (1) monitoring all aspects of the insurance industry (other than crop, health or stand-alone long-term care insurance), including systemic risk and affordability, (2) recommending to FSOC any insurers that should be treated as systemically important, (3) assisting with the Treasury Department’s administration of the Terrorism Risk Insurance Program, (4) coordinating federal policy on international insurance matters, and (5) consulting with state regulators regarding matters of national and international importance. While lacking the authority to supervise insurance companies, the FIO can request data directly from insurers and issue subpoenas. The Act also jointly empowers the Treasury Department and the U.S. Trade Representative to negotiate and enter into “covered agreements” with foreign governments in order to provide for regulatory equivalency between domestic and foreign insurers.

Dodd-Frank also contains the Nonadmitted and Reinsurance Reform Act of 2010, streamlining regulation of insurance companies not licensed by a particular state (nonadmitted insurers) by limiting state regulatory authority strictly to the home state of the insured. Thus, the insurance department of one state cannot act extraterritorially to protect insureds in another state (except with respect to prohibitions on placement of workers’ compensation coverage with nonadmitted insurers). Regulation of reinsurance is similarly streamlined by giving the domiciliary state of the ceding insurer sole regulatory authority over credit for reinsurance and the terms of reinsurance contracts, and by giving the domiciliary state of the reinsurer sole regulatory authority over financial solvency and disclosure of financial information, so long as the domiciliary state’s laws comply with the guidelines of the National Association of Insurance Commissioners.

Derivatives, Asset Backed Securities and Bank Trading Activities

Wall Street Transparency and Accountability – Derivatives Markets and Regulation

Many standard derivatives (commodity futures, stock index futures, etc.) are currently traded on various boards of trade (the Chicago Board of Trade, etc). Pricing is shown on a public, real-time basis, and margin and collateral requirements are regulated by the applicable board of trade and the Commodity Futures Trading Commission (“CFTC”). But many other derivatives are customized and traded “over the counter” – one-on-one negotiations, including terms, pricing and collateral requirements. Increasingly exotic derivatives (credit default swaps, total return swaps, etc.) came to represent enormous potential obligations of their counterparties, which presented the following problems for the financial system:

1. *They were complex* – not even the counterparties to a given trade were always certain of the actual obligations they had undertaken.
2. *They were impossible to price, both initially and ongoing* – such a derivative was so unique that “price discovery” was impossible – the “reference asset” (often an exotic security itself, such as a collateralized debt obligation) was illiquid and held in only a few hands, and itself so complex that establishing a value for the reference asset, much less the related derivative, became entirely subjective and within the discretion of the counterparty with the right to calculate the current value of the derivative contract.
3. *Margin and collateral requirements*, both initially and ongoing, were similarly highly subjective and under the control of a small number of dealers.
4. *They were private* – because there was no exchange or other central repository of data on over-the-counter derivatives, financial markets operated largely on rumor and hearsay regarding which market participants were under stress due to their derivatives exposures and collateral-posting obligations.

Dodd-Frank attempts to address these perceived shortcomings in the over-the-counter derivatives markets. Because some swaps traditionally have been governed by the Commodities Exchange Act and regulated by the CFTC, while other “security-based swaps” traditionally have been governed by the federal securities laws and regulated by the Securities and Exchange Commission (“SEC”), the Act contains a generally matching set of legislative amendments and regulatory mandates for “swaps” (amending the Commodities Exchange Act and directing the CFTC to conduct studies and adopt rules) and “security-based swaps” (amending the federal securities laws and directing the SEC to conduct studies and adopt rules), with a few “work it out amongst yourselves” mandates for the CFTC and SEC to work out regulations relating to “mixed swaps” that might fall under the jurisdiction of both. Although there are some minor differences between the “swaps” provisions and the “security-based swaps” provisions, the remainder of this summary will describe both sets of provisions concurrently and refer to them as “swaps.”

1. *Clearing* – most swaps should be subject to “clearing,” meaning that a registered “derivatives clearing organization” or “clearing agency” has accepted that swap for clearing, and has taken over the process of settlement (whether cash or physical delivery of some asset) of the swap. Requiring clearing for swaps is expected to reduce the credit risk, and uncertainty regarding credit risk, that any one counterparty or any one type of swap presents to the overall financial system, because clearing agencies rather than individual counterparties will assume the

risk that counterparties will not be able to fulfill their obligations, and clearing agencies rather than individual counterparties will establish initial margin and collateral requirements for a particular swap and counterparty, and will monitor and enforce ongoing “variation margin” requirements as the notional value of the swap or creditworthiness of a counterparty changes over time.

A counterparty may elect to have a swap not be subject to clearing if that counterparty:

(a) is not a “financial entity” (which includes swap dealers and major swap participants and banks (although the regulators are authorized to consider whether small banks should be entitled to the end-user exception));

(b) is using that swap to hedge or mitigate commercial risk; and

(c) notifies the applicable regulator (the CFTC or the SEC) how it generally meets its swap financial obligations.

If the end-user electing not to have a swap cleared is a public company subject to the reporting obligations of the 1934 Act, however, this decision must be approved by the company’s board of directors or an appropriate committee of the board.

Conversely, even though a swap is not subject to the mandatory clearing requirement, if one counterparty to that swap is a swap dealer or major swap participant and the other party is not a swap dealer or a major swap participant, that other party may elect to have the swap cleared and may select the clearing agency.

2. *Exchange Trading* – all swaps that are subject to the mandatory clearing requirement should be executed on registered exchanges or “swap execution facilities.” Exchange trading of swaps, the legislation presumes, will increase the price transparency of swaps and reduce the information advantage currently held by a small number of swap dealers.

3. *Swap Data Repositories* – all trading data (whether the swap was traded on an exchange or not) must be reported to a “swap data repository” which will make price and volume data publicly available.

4. *Regulation of Market Participants* – the legislation creates three tiers of swap market participants: Swap Dealers and Major Swap Participants (each as further defined by the Act) and all other swap counterparties, with each tier subject to corresponding levels of regulatory oversight.

5. *Swaps Push-Out* – a late addition to the bill was a prohibition on “federal assistance” to any Swap Dealer or Major Swap Participant. This prohibition would include an insured depository institution that is a major swap participant, unless the insured depository institution’s swap activities are limited to (a) hedging directly related to its own activities, and (b) swaps involving rates or reference assets that are permissible for investment by a national bank (and credit default swaps are expressly excluded from that list). An insured depository institution is thereby effectively required to move all other swap activities to an affiliate entity (which would be eligible for “federal assistance”). Credit exposure on swap transactions by insured depository institutions is also made subject to the institution’s lending limit and affiliate transaction regulations.

Asset-Backed Securitization

Dodd-Frank seeks to remedy perceived defects in the asset-backed securitization process by mandating risk retention by securitizers and enhanced disclosure and reporting regarding the assets supporting asset-backed securities. These mandates overlap with rules proposed by the SEC in April.

Dodd-Frank requires the SEC and federal banking agencies to prescribe regulations requiring securitizers to retain an economic interest in a portion of the credit risk for any asset that the securitizer transfers, sells or conveys to a third party through the issuance of an asset-backed security (“ABS”).

The Act sets the required risk retention levels at:

1. 5% for most asset-backed securities;
2. 0% for asset-backed securities collateralized entirely by “qualified residential mortgages” (a term to be defined in the regulations, identifying residential mortgage loans that present low credit risk); and
3. levels to be determined by the regulators for commercial mortgage-backed securities, and collateralized debt obligations and similar instruments collateralized by other asset-backed securities.

The securitizer may retain less than five percent if the originator of the asset meets certain underwriting standards. In addition, the SEC and federal banking agencies may provide for exemptions, exceptions or adjustments for classes of institutions or assets. The regulations may also prescribe an allocation of risk retention between the originator of the asset and the securitizer. The retained risk may not be directly or indirectly hedged or otherwise transferred. The SEC’s April rule proposal has many of these risk retention requirements, but does not contemplate variations in the risk retention requirement by asset, and would impose the risk retention requirement only on “shelf registration” offerings of asset-backed securities. The FDIC’s proposed rule relating to bank-sponsored securitizations, published on May 17, 2010, also contains a 5% risk retention level for all securitizations.

Dodd-Frank requires that the SEC and federal banking agencies prescribe rules that provide for enhanced reporting and disclosure by issuers regarding the quality of the assets underlying securities, which is also included in the SEC’s April rule proposal. The Act also requires that the SEC prescribe rules for enhanced disclosure regarding representations and warranties made concerning the underlying assets. Each nationally recognized statistical rating organization will be required to include in any report accompanying a credit rating a description of the representations, warranties and enforcement mechanisms available to investors and an explanation of how they differ from those available in similar issuances, and the securitizer will be required to disclose all fulfilled and unfulfilled requests to repurchase assets due to a claimed breach of those representations and warranties. Similarly, the Act requires the SEC to adopt regulations requiring the issuer of a registered offering of asset-backed securities to perform a review of the assets underlying the ABS and to disclose the nature of that review. The SEC’s April rule proposal includes enhanced disclosure regarding representations and warranties and required due diligence reviews.

Dodd-Frank prohibits underwriters, placement agents, initial purchasers or sponsors, and affiliates or subsidiaries of these entities, from engaging in transactions with material conflicts of interest for one year after the closing of a sale of an asset-backed security. The following are not prohibited: (1) risk-mitigating hedging activities in connection with positions arising out of the underwriting, placement, initial purchase, or sponsorship of an asset-backed security; (2) the purchases or sales of asset-backed securities pursuant to commitments of the underwriter, placement agent, initial purchaser, or sponsor, or any affiliate or subsidiary of any such entity to provide liquidity of the asset-backed security; or (3) bona-fide market-making in the asset-backed security.

Regulation of Credit Rating Agencies

Dodd-Frank aims to provide for increased oversight of credit rating agencies, provide greater transparency in the rating process, increase the accountability of credit rating agencies, and address conflicts of interest in the ratings process. In particular, the Act creates a new Office of Credit Ratings. The new office will be responsible for overseeing and monitoring credit rating agencies and conducting examinations of credit rating agencies, and will have the authority to revoke a rating agency's registration as a nationally recognized statistical rating organization ("NRSRO") with respect to a class of securities.

The Act implements a number of disclosure and transparency requirements for NRSROs. The Act mandates SEC rulemaking with respect to the disclosure by NRSROs relating to rating methodologies, including a form to be filed with the SEC with respect to each rating assigned by the NRSRO, describing in detail the assumptions made and the data relied on in assigning that rating, as well a description of any on-going surveillance contemplated by the rating agency. The Act also requires the issuer or underwriter of an asset-backed security to make publicly available the conclusions and findings of any third-party due diligence reports. The SEC is directed to adopt rules requiring NRSROs to implement policies clearly defining and disclosing what each rating and each rating symbol means, and to apply such ratings and symbols consistently across all rating categories. The SEC is further directed to issue rules designed to ensure that rating analysts meet standards of training, experience and competence, and are tested on their knowledge of the credit rating process. NRSROs are required to implement various internal controls and implement various corporate governance processes, including a board of directors with independent directors, and to submit an annual internal controls report to the SEC.

The Volcker Rule

Subject to specified exceptions, the Volcker Rule restricts proprietary trading and holding ownership interests in or sponsoring hedge funds and private equity funds by (1) prohibiting banking entities from engaging in these activities, and (2) subjecting systemically important non-bank financial companies engaging in such activities to additional capital requirements and other limitations to be prescribed by regulation. Proprietary trading includes engaging in securities transactions as a principal 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. Covered banking entities include: (a) insured depository institutions and companies that control insured depository institutions, (b) foreign banks with a U.S. branch, agency or commercial lending subsidiary and companies that control such foreign banks, and (c) affiliates and subsidiaries of the foregoing entities. In general, the Volcker Rule takes effect two years after enactment and then entities subject to the rule have an additional two years to comply.

Exceptions from the restrictions on proprietary trading include the following permitted activities: (1) transactions in U.S. government and U.S. government agency securities, obligations of or instruments issued by Ginne Mae, Fannie Mae, Freddie Mac, Federal Home Loan Banks, Farmer Mac and any Farm Credit System institution, and state or municipal obligations; (2) certain underwriting and market-making activities; (3) certain risk-mitigating hedging activities; (4) trading on behalf of customers; (5) investments in Small Business Investment Companies; (6) certain insurance company general account investment activities; and (7) trading by a foreign company outside the U.S. if the company is not controlled by a company within the U.S. Permitted activity exceptions do not apply if an activity would result in a material conflict of interest with a client, customer or counterparty; material exposure to high-risk assets or high-risk trading strategies, a threat to an institution's safety and soundness, or a threat to U.S. financial stability.

Exceptions from the restrictions on hedge fund and private equity fund activities include: (1) the permitted activities listed as exceptions to the prohibition on proprietary trading, (2) organizing and offering interests in funds that a banking entity provides bona fide trust, fiduciary or investment advisory services to, but only if offered in connection with the provision of such services and in accordance with other specific limitations; (3) investments in hedge funds or private equity funds organized or offered by the banking entity and that are limited to initial equity to permit the fund to attract initial investors or a *de minimis* investment, provided that unaffiliated investors are actively sought, the investment in the fund is reduced to no more than 3% of the fund's total ownership interests within a year of formation and the banking entity's aggregate investment in such funds is no more than 3% of its Tier 1 capital.

Investor Protections and Improvements to the Regulation of Securities

Strengthening Corporate Governance

Although the requirement for majority voting in director elections was eliminated and the say-on-pay provisions were made more obtuse by the conference committee, Dodd-Frank preserves most of the features relating to corporate governance and executive compensation contained in the version of the bill passed by the Senate.

Shareholder Approval of Executive Compensation. The Act requires companies that provide executive compensation disclosure under the SEC's proxy rules to include nonbinding "say-on-pay" proposals in their proxy statements at least once every three years, and non-binding proposals to approve any "golden parachute" arrangement in all proxy statements relating to business combinations.

Broker Discretionary Votes. Mirroring the changes of last summer caused by the passage of New York Stock Exchange Rule 452 and effective immediately, brokers are prohibited from voting shares held in street name on matters related to the election of directors, executive compensation or other significant matters as determined by the SEC, unless the broker has received instructions from the beneficial owner. The provision marks a reversal of the SEC's conclusion, in January 2010, that broker's may exercise discretionary authority in voting for say-on-pay proposals that are required under TARP, and might mark the end of "easy approval" of say-on-pay votes.

Executive Compensation Disclosure—Pay versus Performance. The Act also requires that the SEC adopt regulations requiring companies to disclose in their proxy statements the relationship between the amount of executive compensation actually paid to executive officers and the financial performance of the company and effectively invites the SEC to require that this information be presented graphically. More specifically, the SEC must amend its executive compensation rule (Item 402 of Regulation S-K) to require disclosure of the

- (i) median total annual compensation paid to all employees other than the chief executive officer;
- (ii) the total annual compensation paid to the chief executive officer; and
- (iii) the ratio between these two amounts.

In what may create a burden for smaller companies that do not have computerized compensation records or that have broad-based equity compensation plans, the Act requires that total compensation both for purposes of executive compensation and for purposes of median employee compensation be computed in the same manner as total compensation is computed for executives in the summary compensation table.

Leadership Structure. The Act requires the SEC to issue rules requiring disclosure in proxy statements of why the issuer has chosen to have the same person or different persons serving as the Chairman of the Board and the Chief Executive Officer. Because the SEC adopted last December rules that already require disclosure of whether the same person serves as Chairman and CEO and virtually all issuers have included descriptions of why, this change seems designed only to codify the requirement.

Proxy Access. The Act gives the SEC explicit authority to issue rules permitting shareholder access to proxy materials in order to nominate candidates to the Board of Directors. The SEC is also authorized to establish exemptions for certain issuers and will consider whether the requirements of proxy access disproportionately burden smaller issuers. Before enactment of the Act, the SEC issued a concept release asking for public comment on the effectiveness of its proxy rules and whether rules should be published to promote greater efficiency and transparency. These changes, together with a comprehensive proxy access rule, are expected later this year.

Disclosure of Hedging Policies. The Act requires the SEC to issue rules requiring public companies to disclose in their proxy statements whether directors and employees are permitted to hedge the value of equity securities held directly or indirectly by the director or employee. Unlike Section 16(c) of the Exchange Act, which prohibits only short sale transactions by officers and directors, this new rule will likely prompt the adoption of more comprehensive anti-hedging policies applicable to all hedging transactions for all employees.

Additional Requirements for Listed Companies. The Act requires the SEC to adopt regulations that will prohibit national securities exchanges or associations from listing companies that do not have independent compensation committees or that have not adopted clawback policies. The policy required under the section will require the issuer to recover from any current or former executive officer any incentive compensation that was paid during the three years preceding any accounting restatement due to material noncompliance with reporting requirements, to the extent in excess of the compensation that would have been paid based on the restatement. Importantly, unlike Section 304 of Sarbanes Oxley, the new clawback policies will apply (1) regardless of the misconduct of the officer receiving incentive compensation, and regardless of misconduct by the issuer, (2) to all incentive compensation paid during the three year period preceding the restatement, rather than the 12 months following publication of the erroneous report, and (3) to all executive officers, not just the Chief Executive Officer and Chief Financial Officer.

SOX 404 Amendments. In a tacit acknowledgement of the burdens excessive rulemaking can impose, the Act expressly exempts issuers that are neither “large accelerated filers” nor “accelerated filers” from the requirement contained in Section 404(b) of The Sarbanes Oxley Act of 2002 to provide an auditor attestation of internal control over financial reporting. In the next nine months, the SEC is also required to conduct a study to determine how to reduce the burden of complying with Section 404(b) for companies whose market capitalization is between \$75 million and \$250 million while maintaining investor protections.

Advisers, Private Investment Funds and Private Placements

From a regulatory perspective, what made private investment funds special were exemptions or exclusions from regulation. These private funds, generally referred to in the public as “hedge funds,” benefit from specific exclusions from the definition of an Investment Company Act of 1940 (“Investment Company Act”). Since each fund only counted as one client, advisers to the funds were able to rely on an exemption from registration under the Investment Advisers Act of 1940 (the “Advisers Act”) for advisers with fewer than 15 clients.

Dodd-Frank eliminates the fewer than 15 clients exemption from registration under the Advisers Act. In addition, the threshold for the amount of assets under management required to subject an adviser to registration with the SEC has been increased from \$25 million of assets under management to \$100 million of assets under management. As a result, all investment advisers to “private funds” with aggregate assets of greater than \$100 million will be subject to registration as advisers under the Advisers Act within one year after the date of enactment unless an exemption, described below, is available. “Private funds” for these purposes are funds that rely on the exclusions from the definition of an investment company pursuant to Section 3(c)(1) or 3(c)(7) of the Investment Company Act.

Federal registration of an adviser pre-empts most state regulation of that adviser. With the increase in the assets under management threshold for SEC registration it is likely there will be a significant increase is expected in the number of advisers under state supervision.

Exemptions from Adviser Registration and Reporting Obligations

Dodd-Frank provides exemptions from registration under the Investment Advisers Act to advisers of the following categories of private funds and pooled investment vehicles: (i) advisers to private funds that have less than \$150 million of assets under management; (ii) advisers to venture capital funds, with the term “venture capital fund” to be defined by the SEC; (iii) advisers to Small Business Investment Companies; (iv) Family Offices, with the term “family office” to be defined by the SEC in a manner consistent with its prior exemptive orders for family offices; and (v) foreign private fund advisers, as defined by the Act. The exemption for private equity funds was deleted in the final conference committee report. Although exempt from registration, advisers to venture capital funds and private funds below the threshold amount will be subject to annual and other types of reporting obligations to the SEC pursuant to rules to be developed.

Broker-Dealer and Investment Advisor Fiduciary Duty Harmonization

Brokers and dealers are currently excluded from the definition of “investment adviser” under the Advisers Act if their advisory activities are solely incidental to brokerage activities and they receive no special sales compensation. Dodd-Frank authorizes the SEC to study the standards of care of broker-dealers and investment advisers when providing “personalized investment advice” to “retail customers.” A retail customer is defined as a natural person who receives personalized investment advice regarding securities and uses such advice primarily for personal, family or household purposes. The results of the study are to be reported to Congress within 6 months of enactment.

Dodd Frank provides that the SEC may promulgate rules that would subject broker-dealers to the same standard of conduct as an investment adviser when providing personalized investment advice about securities to retail customers (and such other customers as the SEC may by rule

provide). Such rules would not impose on a broker-dealer a continuing duty of care or loyalty to the retail customer after he or she provides personalized investment advice about securities. Broker-dealers and investment advisers are also permitted to give advice that might cause them conflicts of interest, as long as those conflicts are disclosed and consent is obtained.

Disclosure Requirements

The SEC is further charged with: (i) facilitating 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, and (ii) examining, and where appropriate, promulgating rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisors that the SEC deems contrary to public interest and the protection of investors.

Private Placements under Regulation D

Disqualified Persons

The SEC is required to issue rules for the disqualification of certain offerings and sales of securities made under Section 506 of Regulation D. Specifically, the SEC is required to disqualify felons and other “bad actors” (as defined in the Act and under existing SEC regulations) from Regulation D offerings.

Revised Definition of Accredited Investor

Currently, an investor with a net worth of \$1 million is deemed an accredited investor pursuant to SEC rules. Effective immediately upon signing of Dodd-Frank, the definition of an accredited investor is revised to exclude from an investor's net worth calculation the value of the investor's primary residence. The SEC Staff has stated that the amount excluded from the net worth calculation should be the net figure after deducting any mortgage and if the mortgage exceeds the value then the amount of the obligation must be included as a debit item in the calculation. The SEC is required to review the accredited investor standard at least every four years to determine if it should be adjusted for the protection of investors, in the public interest and in light of the economy.

Mandatory Pre-Dispute Arbitration Clauses

Under Dodd-Frank, the SEC may, by rule, prohibit or impose conditions or limitations on the use of agreements that require customers or clients of any broker, dealer, municipal securities dealer or investment adviser to arbitrate any future dispute arising under the federal securities laws or the rules of an SRO, if it is in the public interest and for the protection of investors.

Aiding and Abetting Violations

Dodd-Frank amends the Securities Act and the Investment Company Act by extending “aiding and abetting” liability to any person that knowingly or recklessly provides substantial assistance to another person in violation of the provisions of either act. In addition, the standard of knowledge in an aiding and abetting investigation is satisfied by a showing of recklessness. Dodd-Frank includes similar amendments to Investment Advisers Act by extending liability to any person that knowingly or recklessly has aided, abetted, counseled, commanded, induced, or procured a violation of any provision of that Act. Finally, the SEC's enforcement authority with respect to

aiding and abetting violations under federal securities laws is strengthened by authorizing the imposition of monetary penalties for such violations.

Municipal Securities Advisors

Dodd-Frank requires municipal advisors to register under the Exchange Act. A municipal advisor is now defined as a person who, for compensation, provides advice to municipal issuers with respect to the issuance of municipal securities, the investment of proceeds and the structure, timing or terms of the issuance, or undertakes a solicitation of a municipal entity.

Dodd-Frank further amends the Exchange Act by imposing a fiduciary duty on municipal advisers and any persons associated with such advisers with respect to the municipal entity for whom they act as a municipal adviser. Dodd-Frank does not specify the contours of this fiduciary duty, but does provide that no municipal adviser may engage in any act, practice or course of business which is not consistent with a municipal adviser's fiduciary duty or that is in contravention of any rule of the Municipal Securities Rulemaking Board ("MSRB"). Dodd-Frank also requires reconstitution and expansion of the MSRB's authority.

Capital Requirements for Banking Organizations and the Collins Amendment

Although a number of sections of Dodd-Frank address the minimum capital requirements applicable to banks, thrifts and their holding companies, the Collins Amendment drew a substantial amount of attention during the last month of the legislative process. Offered at the suggestion of the FDIC, the Collins Amendment eliminates differences between the capital standards applicable to bank holding companies and insured depository institutions, marking the beginning of the end of Trust Preferred Securities (“TRUPs”) for all but the smallest bank holding companies.

As adopted, the Collins Amendment subjects holding companies to minimum leverage and risk-based capital requirements no less than the minimum ratios currently applicable to depository institutions under prompt corrective action regulations. Calculation of these ratios must also be consistent with the calculations used for depository institutions, which do not include TRUPs in the calculation of Tier 1 capital. The Collins Amendment includes exceptions and phase out provisions that generally favor smaller organizations. Holding companies with assets of less than \$500 million are exempt from the provisions of the Collins Amendment and remain subject to the Fed’s Small Bank Holding Company Policy Statement. TRUPs and other similar instruments issued before May 19, 2010 are permanently grandfathered for holding companies with consolidated assets of less than \$15 billion and for larger institutions, phased out over 3 years beginning January 1, 2013. Other exemptions and grandfathering provisions also apply to specific types of institutions.

In addition to the Collins Amendment, Dodd-Frank contains other provisions that promise to impact capital requirements. The Financial Stability Oversight Council can make recommendations to the Federal Reserve to establish higher prudential standards for risk based capital, leverage, liquidity and contingent capital for non-bank financial holding companies supervised by the Federal Reserve and bank holding companies with total consolidated asset of \$50 billion or greater. FSOC can also make recommendations to the primary federal regulators of other banking organizations, regardless of size, to apply new or heightened prudential standards and safeguards to activities and practices that could create increased risks, including the application of capital requirements.

Dodd-Frank instructs regulatory agencies to make capital requirements countercyclical, with the amount of capital to be maintained increasing in times of economic expansion and decreasing in time of contraction. The Act also adopts an amended source of strength doctrine, allowing regulators to look to other companies that directly or indirectly control a depository institution to serve as a source of strength for a depository institution that does not have a holding company. The Act revises the capital criteria for Financial Holding Company status beyond requiring that all depository institution subsidiaries be well capitalized to require that the holding company be well capitalized as well. Finally, the Act increases the capital requirement for approval of acquisitions from adequately capitalized to well capitalized.

Regulation of Bank Products and Services

Bureau of Consumer Financial Protection

One of the major elements of Dodd-Frank is the creation of the Bureau of Consumer Financial Protection (“BCFP”), an autonomous bureau housed within the Federal Reserve, which will have the authority to interpret and enforce some sixteen federal consumer financial protection laws and will supervise some large financial institutions and many non-bank financial service providers that are not currently subject to federal supervision.

Rulemaking, Supervisory and Enforcement Authority

The BCFP is authorized to regulate the activities of any person or entity (a “covered person”) engaged in the business of providing consumer financial products or services, including taking deposits; extending credit; servicing loans; leasing or brokering leases of real or personal property on a rent-to-own basis; transmitting money; selling, providing or issuing general-purpose stored value products; cashing checks; providing credit counseling and other forms of financial advice; collecting debts; and producing consumer reports. Small businesses, merchants that extend store credit, real estate agents (if not brokering loans), accountants, attorneys, auto dealers and manufactured home sellers are all exempt from supervision by the BCFP but such exempt entities do remain subject to federal consumer protection laws such as the Fair Credit Reporting Act and Truth in Lending Act to the extent that they engage in activities governed by those laws and could be subject to other activity based regulations.

Not all covered persons will be subject to active supervision or examination by the BCFP. The BCFP will supervise the consumer activities of financial institutions with consolidated assets in excess of \$10 billion, as well as mortgage originators, payday lenders, private student loan companies and other participants in consumer financial product markets that are “larger” or pose unusual risks to consumers. Smaller financial institutions will continue to be examined by their existing state and federal regulators as to compliance with consumer protection laws. The scope of the BCFP’s supervisory powers will need to be clarified in rulemaking.

In addition to its supervisory powers, the BCFP has authority to enforce federal consumer financial protection laws through administrative proceedings and civil actions. It may impose penalties for violations of such laws ranging from \$5,000 to \$1,000,000 per day, depending on the severity of the violation.

Changes to Consumer Protection Laws

Several changes to substantive consumer protection laws are included within the BCFP provisions, including the following:

- Covered persons are required to make available to a consumer, upon request, all information in their possession concerning that consumer.
- The Electronic Funds Transfer Act is amended to create new disclosure requirements for foreign money remittances.

- The Fair Credit Reporting Act is amended to require creditors to disclose an applicant's credit score when sending an adverse action notice related to a credit application.
- The Equal Credit Opportunity Act is amended to require lenders to collect data concerning commercial loans to minority- and women-owned businesses.
- The BCFP and HUD are directed jointly to create a new consumer disclosure form for home mortgage loans.
- The Truth in Lending Act is amended to apply to consumer loans of up to \$50,000 (the prior limit was \$25,000).

In addition to the foregoing changes, the BCFP is directed to conduct studies and to make recommendations for statutory or regulatory improvements with respect to several consumer protection issues, including reverse mortgages, credit scoring systems and the use of mandatory arbitration clauses.

Federal Preemption

Dodd-Frank codifies and to some extent overturns certain Supreme Court decisions concerning the scope of preemption under the National Bank Act. Under the standard established by the Act, state consumer protection laws are preempted with respect to national banks only if such laws discriminate against national banks as compared to state banks; if another provision of federal law expressly preempts state law; or if the OCC determines, on a case-by-case basis, that the state law significantly interferes with a national bank's exercise of its powers. This provision largely tracks the standard set by the Supreme Court in the 1996 case, *Barnett Bank of Marion County, N.A. v. Nelson*, with the added requirements that the OCC consult with the BCFP on preemption determinations, that it have substantial evidence for its determination, and that it review such determinations every five years. The Act also codifies the Supreme Court's finding in *Cuomo v. Clearing House Association*, that state attorneys general have the power to sue national banks to enforce state laws and to subpoena evidence in connection with such suits. State attorneys general are also authorized to enforce regulations of the BCFP against national banks within their jurisdictions, but not to enforce the provisions of the Act itself. Finally, the Act overturns the Supreme Court's decision in *Watters v. Wachovia Bank*, that non-depository subsidiaries of national banks benefit from federal preemption to the same extent as their bank parents.

Deposit Insurance Coverage and Assessments

Dodd-Frank increases the general insured deposit account limit to \$250,000, making permanent earlier temporary increases of that limit. This change is also retroactive for institutions that the FDIC became receiver or conservator for between January 1 and October 3, 2008, effectively increasing coverage for depositors of institutions that failed before coverage was temporarily increased, such as IndyMac. Unlimited deposit insurance for non-interest bearing deposit accounts previously offered under the Transaction Account Guaranty ("TAG") program is also extended, but only to January 1, 2013 and with some differences from the current TAG program. The extension of the TAG program is beyond the effective date of the repeal of the prohibition on the payment of interest on transaction accounts, introducing the possibility that offers of interest may entice some customers away from the program's protections.

Dodd-Frank makes two significant changes to deposit insurance assessments. In an effort to shift more costs to larger institutions that are less dependent on deposits for funding, deposit insurance assessments will be calculated based on average consolidated total assets minus average tangible equity, rather than on deposits. In the revised conference committee report of June 29, 2010, Congress also decided to use deposit insurance assessments in part to fund the Act by increasing the reserve ratio to 1.35% of estimated insured deposits, but mandated that the FDIC find a way to offset the impact of this increase in setting assessments for institutions with total consolidated worth of less than \$10 billion.

Interest Bearing Transaction Accounts

Dodd-Frank eliminates restrictions on interest-bearing checking accounts dating back to the 1930's. Although this restriction was eliminated in the 1970's and 1980's for consumer deposits, transaction accounts held by business customers remained subject to a prohibition on the payment of interest, spawning a wide range of often complex earnings credit, investment sweep, and compensating balance products to compensate businesses for deposits. Dodd-Frank removes this prohibition one year from enactment. While this change should simplify how businesses are compensated for transaction account deposits, it may also increase the focus on the quality and cost of cash management and other treasury management products and services. In addition, for those depositors that remain concerned about the security of their deposits, the unlimited insurance provided by the FDIC's Transaction Account Guaranty program remains in place until January 2013 but is only applicable to non-interest bearing transaction accounts.

Limits on Interchange Fees – Shifting the Cost of Payment Cards

One of the more controversial elements of Dodd-Frank is the Durbin Amendment, which requires that interchange fees paid by merchants for debit card and some stored value card transactions be "reasonable and proportional" to the issuer's transaction costs. The details of this restriction are left to Federal Reserve regulations to be published within the next nine months, but the costs that may be considered in setting interchange fees do not include overhead or card production expenses. Since such expenses are currently covered in whole or in part by interchange, the Durbin Amendment will in all likelihood result in a reallocation of card costs between banks and consumers. Subject to some qualifications, benefit cards issued by state and federal government agencies, cards issued by financial institutions with less than \$10 billion in consolidated assets, and general purpose prepaid cards that are not marketed as gift cards are exempt from the Durbin Amendment.

Dodd-Frank also prohibits some card network rules that limit a merchant's ability to discriminate among different payment methods and different types of cards. Card networks may no longer impose exclusivity obligations, prevent merchants from setting minimum card purchase requirements (although the Act requires that any merchant established minimums be \$10 or less), or prohibit merchants from offering discounts for their preferred payment method (i.e., cash, check or debit). These provisions will enable merchants to be more selective about accepting credit, debit and stored value cards.

Mortgage Reform and Anti-Predatory Lending

Dodd-Frank contains a number of provisions addressing mortgage lending practices that are thought by some to have contributed to the subprime crisis. Among other things, the Act prohibits creditors from providing incentives for mortgage originators to steer consumers to higher-priced

or riskier loans; it requires mortgage lenders to document and verify a consumer's ability to repay a mortgage loan; it prohibits prepayment penalties on certain "non-qualified" (higher risk) mortgage loans and limits prepayment penalties on conventional mortgage loans; it prohibits financing of single-premium credit insurance; and it prohibits mandatory arbitration clauses in mortgage loan agreements. Dodd-Frank requires enhanced consumer disclosures for loans with negative amortization or hybrid interest rate features and it introduces new disclosure requirements for monthly loan statements. Finally, the Act establishes new requirements for mortgage appraisals, including minimum state licensing standards, a national registry of appraisal management companies and enhanced appraiser independence requirements for loans made under federal programs and for "high-cost" mortgage loans.

Dodd-Frank also seeks to improve the financial literacy of borrowers, creating the Office of Housing Counseling within HUD. The office is directed to establish standards and procedures for home loan counseling required in connection with loans made under many federal housing programs.

Other Improvements to Bank Regulation

Deposit Insurance and Change in Control Moratorium for Credit Card Banks, Industrial Banks and Trust Banks

Dodd-Frank establishes a three year moratorium (from date of enactment) on the approval of deposit insurance for and changes in control of Credit Card Banks, Industrial Banks and Trust Banks. The moratorium covers applications for deposit insurance received after November 23, 2009, and, subject to certain exceptions, a change in control under the Change in Bank Control Act may not be approved if the transaction would result in the direct or indirect control of the institution by a Commercial Firm. A “Commercial Firm” is any firm that derives less than 15 percent of its consolidated annual gross revenues from activities that are financial in nature, as defined in Section 4(k) of the Bank Holding Company Act of 1956. Exceptions to the change in control moratorium include transactions which result in an acquirer holding less than 25% of any class of the voting shares of a publicly traded company that is or controls a covered bank and mergers or acquisitions of a Commercial Firm that controls a covered bank by another Commercial Firm. In the 18 months following enactment, a study must be completed on a number of related exceptions to the definition of a bank holding company under the Bank Holding Company Act. In addition to the exceptions relating to control of Credit Card Banks, Industrial Banks and Trust Banks, exceptions relating to control of Savings Associations are also included in the scope of the required study.

Reports and Examinations of Holding Companies; Regulation Functionally Regulates Subsidiaries

Dodd-Frank expands the Federal Reserve’s authority to request reports from bank and thrift holding companies and their subsidiaries, to receive access to reports provided to other regulators and to examine holding company subsidiaries. The Federal Reserve will use existing regulatory reports and coordinate with other regulators in order to avoid duplication of efforts.

The criteria used to evaluate and approve bank and thrift acquisitions are amended to include consideration of the impact on the stability of the financial and banking system.

Acquisitions of companies, other than depository institutions, engaged in activities that are financial in nature require prior approval by the Federal Reserve if the consolidated assets to be acquired exceed \$10 billion. Acquisitions of companies, other than depository institutions, that engage in activities that are financial in nature are not exempt from Hart-Scott-Rodino pre-merger notification requirements based on a requirement for Federal Reserve approval.

Increased Oversight of Non-Depository Institution Subsidiaries of Holding Companies

The frequency and scope of examinations of non-depository subsidiaries of holding companies is increased, to the extent subsidiaries are engaged in activities otherwise permissible for a depository institution. Examinations are required to be conducted in the same manner, subject to the same standards and with the same frequency as if the activities of the subsidiary were conducted in the lead depository institution of the holding company.

Restrictions on Charter Conversions of Troubled Banks

Banks are prohibited from converting charters while subject to a regulatory cease and desist order or a memorandum of understanding with respect to a significant supervisory matter, unless the regulatory agency issuing the enforcement action does not object following notice.

Purchase of Assets from Bank Insiders

Assets purchased from or sold to an executive officer, director or principal shareholder and any of their related interests must be on market terms and, if representing more than 10% of the bank's capital and surplus, approved in advance a majority of the disinterested directors.

Limits on Large Financial Firms and Related Merger Transactions

Dodd-Frank prohibits a financial company from taking control of another company through a merger, consolidation, acquisition, or other means if the acquiring company would end up with consolidated liabilities greater than 10% of the aggregate liabilities of all financial companies. There are exceptions, subject to Federal Reserve approval, for banks in default or danger of default, situations where the FDIC provides assistance, and situations where the acquisition would only create a *de minimis* increase in the acquirer's liabilities.

An interstate merger transactions may not be approved if the resulting insured depository institution would control more than 10% of the total amount of deposits of all insured depository institutions in the United States. Bank and thrift holding companies also may not acquire insured depository institutions if the entities have different home states and the applicant would then control more than 10% of the total amount of deposits of all insured depository institutions in the United States.

Intermediate Holding Companies

The Federal Reserve may require grandfathered unitary savings and loan holding companies to conduct financial activities, other than internal financial activities, through intermediate holding companies. A grandfathered unitary savings and loan holding company that controls an intermediate holding company must be a source of strength for the intermediate holding company.

Elimination of the Office of Thrift Supervision

In response to the savings and loan crisis in the 1980's, the Financial Institutions Reform Recovery and Enforcement Act ("FIRREA") abolished both the Federal Savings and Loan Insurance Fund ("FSLIC") and the Federal Home Loan Bank Board ("FHLBB"). While the insurance functions of FSLIC were transferred to the FDIC, the functions of the FHLBB were transferred to the newly formed Office of Thrift Supervision ("OTS"), which became the primary federal regulator for savings associations and their holding companies.

One year after enactment, Dodd-Frank puts an end to the FHLBB/OTS family line, abolishing the OTS and dividing its functions among the new Bureau of Consumer Financial Protection and three of the remaining legacy financial institution regulators. As is the case with all of the federal banking agencies, certain functions related to consumer protection are transferred to the BCFP. Supervision of Savings and Loan Holding Companies (including non-depository institution

subsidiaries) and regulation of savings association tying arrangements and transactions with affiliates are transferred to the Federal Reserve. Supervision of Federal Savings Associations is transferred to the OCC, and a new office of Deputy Controller for Examination and Supervision of Federal Savings Associations is created. Supervision of State Savings Associations is transferred to the FDIC. Existing regulations and orders of the OTS are carried forward, and each replacement agency is required to publish a list of the OTS regulations that remain in force. OTS regulations published before it is abolished will become effective unless revised, and regulations under consideration will be considered by the appropriate successor agency. Finally, the seat on the Board of Directors of the FDIC formerly held by the Director of OTS is transferred to the Director of the new BCFP.

Responding to the Next Crisis

From Too Big To Fail to Orderly Liquidation

Under Dodd-Frank, any financial company can be designated as a covered financial company enabling the Treasury Secretary to appoint the FDIC as receiver in order to facilitate the orderly liquidation of the company. Potentially covered financial companies include bank holding companies, non-bank financial companies regulated by the Federal Reserve (presumably through designation as systemically important by FSO), other companies predominantly engaged in activities that are financial in nature under Section 4(k) of the Bank Holding Company Act of 1956, and subsidiaries of any the foregoing that are themselves predominantly engaged in activities that are financial in nature; but not insured depository institutions. Insurance companies and broker-dealers are also generally excluded but can be subject to this authority with the concurrence of two-thirds of the members of the Securities and Exchange Commission or the director of the Federal Insurance Office, as the case may be.

A company will be deemed to be predominantly engaged in activities that are financial in nature if 85% or more of its gross consolidated annual revenues are derived from activities that are financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956. The activities that fall within this definition include, but are not limited to: (1) lending, exchanging, transferring, investing for others, or safeguarding money or securities; (2) insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing; (3) providing financial, investment, or economic advisory services, including advising an investment company (as defined in section 3 of the Investment Company Act of 1940); (4) issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly; (5) underwriting, dealing in, or making a market in securities; and (6) engaging in any activity that the Federal Reserve has determined as of November 12, 1999, to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. This last category is in turn defined in regulations found in 12 CFR Part 225 and includes another 14 categories of activities. While most are activities normally associated with banking and financial services, a few are not, such as appraisal services, management consulting and counseling, community development activities and financial and economic data processing services.

The requirements for approval to use this authority are that: (1) the company is in default or in danger of default, (2) the company's failure would have serious adverse effects on the financial stability of the United States, (3) no viable private sector alternative is available, (4) the effect on the claims of creditors, counterparties and shareholders and other market participants is appropriate, (5) use of this authority would avoid or mitigate such adverse effects (taking into account adverse effects on the financial system, the general fund of the U.S. Treasury and potential for increased risk taking by creditors, counterparties and shareholders), (6) any federal regulatory agency with authority to do so has ordered the company to convert all of its convertible debt instruments, and (7) there has been a written recommendation addressing the foregoing points as well as the nature and extent of actions being recommended and why a case under the Bankruptcy Code is not appropriate. The recommendation must be approved by two-thirds of the members of the Board of Governors of the Federal Reserve and two-thirds of the members if the Board or Directors of the FDIC, with the concurrences noted above for insurance companies and broker-dealers.

In addition to the foregoing orderly liquidation authority, systemically important large bank holding companies and non-bank financial companies are required to adopt and maintain a plan for the company's rapid and orderly resolution in the event of material financial distress or failure.

Federal Reserve and FDIC Emergency Powers

Dodd-Frank limits the emergency powers of both the Federal Reserve and the FDIC, focusing on certain tools and techniques used by both agencies during the "bailout" phase of the recent economic crisis. The emergency lending authority of the Federal Reserve under Section 13(3) of the Federal Reserve Act is limited, requiring that any emergency lending facilities have "broad based eligibility," as opposed to being targeted at a particular institution, and by prohibiting the extension of credit to insolvent institutions. The purpose of this requirement is to prevent a recurrence of Federal Reserve support for particular, troubled institutions, as occurred in 2008 with respect to Bear, Stearns and AIG. Approval from the Secretary of the Treasury is required for any emergency lending, and the Federal Reserve is required to adopt policies and procedures for emergency lending by regulation. The Act also provides for audits of, and for additional public disclosures of information by, the Federal Reserve.

The FDIC's power to issue guaranties is also restricted. The power may only be exercised after a finding that a "liquidity event" (i.e., a disruption in the market for financial assets, financing secured by financial assets, or market for unsecured financing for financial market participants) has occurred. The finding must be requested by the Secretary of the Treasury and made by the FDIC Board and by the Federal Reserve Board, each acting by a two-thirds majority of serving members. Only solvent insured depository institutions and depository institution holding companies may participate in the program, and Congress, at the recommendation of the President, must approve the maximum amount of debt outstanding that the FDIC may guaranty. The FDIC is charged with covering the costs of the guaranty program and any expected losses in setting the guaranty fee, and recovering any shortfall from special assessments on participants in the program.

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