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TO: CRE Finance Council

FROM: Scott A. Sinder
Rhonda M. Bolton
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RE: House-Senate Conferees Reach Agreement on Financial Regulatory Reform Bill

At approximately 5:30 a.m. on Friday, June 25, House and Senate Conferees concluded an intricate and often confusing negotiation on H.R. 4173, the “Dodd-Frank Wall Street Reform and Consumer Protection Act.” The size and scope of issues addressed contributed to a fluid and often unclear process driven by a series of moving offers, counteroffers and agreements that were at times conceptual or far removed from the base text. As such, the official Conference Agreement was eagerly anticipated and released in phases (as it was drafted by staff) several days *after* the Committee concluded its work. Today, the more than 2300-page bill is publicly available and is largely consistent with the agreements publicly discussed by the Conference Committee, although some variations, drafting changes, and other revisions appear in the final text.

The Conference Agreement, which the Conference Committee approved in a party line vote of 27-16, must now be approved by the full House and Senate before being sent to the President’s desk for signature. The House requires a simple majority vote, while the Senate needs 60 votes to end debate but a simple majority for final passage.

Yesterday, however, a dispute arose over a last minute addition to the bill that would impose \$19 billion in new fees on financial institutions to help pay for the new regulatory regime the bill creates. The dispute led Congressional leadership to reconvene the Conference Committee to resolve the issue by authorizing an early termination of the Troubled Asset Relief Program (TARP) and making changes to the FDIC’s Deposit Insurance Fund. House and Senate leaders continue to press to wrap up the votes this week in order to send the legislation to the President before Congress leaves Washington for the July 4th recess. The House is expected to

consider the measure today, but the Senate's final vote will likely take place after the recess, the week of July 12.

OVERVIEW OF THE RELEVANT CONFERENCE REVISIONS

Overall, several priorities of the CRE Finance Council were included in the Conference Agreement.

Retention. First, there is language requiring regulators to structure risk retention requirements by asset class; second, the language enables regulators to take the unique aspects of commercial real estate finance into account in developing the requirements, including a provision from the Senate version that affords the flexibility to satisfy the “skin-in-the-game” mandate through retention of a percentage of the credit risk, “underwriting standards and controls” that are “adequate,” or “adequate representations and warranties and related enforcement mechanisms.”

Also, regulators will have explicit authority to consider allowing a “third-party investor” (in addition to the “securitizer” or “originator” of loans) to satisfy a potential retention mandate for commercial mortgage-backed securities (“CMBS”), so long as the third-party investor purchases a first-loss position for which it specifically negotiates, performs due diligence, and retains this risk in accordance with the statute’s requirements. A criterion added to this list by the Conferees for third-party investors is that they must hold “adequate financial resources to back losses” to satisfy the retention requirement. This added qualification seems to misunderstand the issue, but under the fast pace of consideration on complicated issues, some lawmakers wanted to include this language to ensure that any party satisfying the retention mandate would remain solvent or sufficiently capitalized to survive the retention period without being forced to transfer the risk. While it was a late addition, it is clear that regulators will have the broad discretion to handle this subjective language (including extending it to originators or securitizers) in a manner that is relevant and practical.

Other notable additions agreed to by the Conferees are a provision explicitly directing regulators to establish risk retention standards for collateralized debt obligations, and a provision directing that regulators establish “clear underwriting standards” for each asset class as part of the creation of class-specific risk retention obligations.

Retention Studies. The Conferees also retained two important study provisions. The first study requires financial regulators to examine and report on the combined impact of new accounting standards (FAS 166 and 167) and other regulatory changes (such as a “retention” mandate) on credit availability, prior to any rulemaking. Under the provision, the Federal Reserve (working with other agencies) would have 90 days to report its findings to Congress with recommendations on statutory and regulatory changes that could be made to reduce the impact on credit availability.

The second study requires the new Financial Services Oversight Council to consider the combined macroeconomic impact of the new securitization reforms and mandates “with emphasis placed on potential beneficial effects with respect to stabilizing the real estate market.”

With respect to other issues, the House mounted an effort to strip out a provision that would direct regulators to exempt “qualified” residential mortgages from having to comply with the risk retention mandate, but the provision was retained.

Credit Rating Agency Reform. Much of the negotiating activity on credit rating agency reform centered on the fate of the “Franken Amendment,” which sought to require creation of a new independent board that would assign nationally recognized statistical rating organizations (“NRSROs,” which are the credit rating entities that have registered with the SEC) to conduct initial ratings of structured finance products. At one point during the debate it appeared that the Franken amendment would be completely eliminated and replaced with language simply directing the SEC to study conflicts of interest. But later the debate seemed to resolve on directing that the SEC had the option to impose a third-party assignment mechanism.

The final text of the bill bolsters the study language, although it seems to vacillate between mandating and suggesting the creation of the new mechanism. Specifically, the text directs that after completing the study the SEC “shall” establish a system for assigning NRSROs to rate new issuances “as the Commission determines is necessary or appropriate in the public interest or for the protection of investors.”

Significantly, the final text of the bill also adds a direction to the SEC that it should implement the system described in the original Franken amendment as passed by the Senate, unless the Commission determines that an alternative system would “better serve the public interest and the protection of investors.”

A second notable credit rating reform issue relates to the standard of liability for NRSROs in private actions, and there was considerable debate as to whether NRSROs should be held liable for gross negligence, as the House advocated, or the tougher “knowing and reckless” standard in the Senate bill, which is more difficult for plaintiffs to prove. The Conferees ultimately agreed to adopt the “knowing and reckless” standard.

The issue of NRSROs providing non-rating-related consulting services to issuers also was debated. Although the House pushed the outright ban that it had passed on such services, the Senate balked at this and a compromise was reached to adopt a “Sense of Congress” provision suggesting that the SEC adopt rules to “prevent improper conflicts of interest” arising from NRSROs providing services unrelated to ratings. The Senate did agree, however, to the House proposal to include requirements for a one year look-back at the ratings of credit analysts who are involved in ratings and then go work for the issuers that obtained the rating, and for reporting to the SEC when NRSRO employees rate issuers’ products and then go to work for those same issuers.

As for the remainder of the risk retention and rating reform provisions, they appear to be largely unchanged, which stands to reason since the House and Senate versions were not

dissimilar in these respects. Accordingly, the final bill will generally impose a number of new requirements on “securitizers,” entities defined as issuers of asset-backed securities (“ABS”) or those who organize or initiate an ABS transaction by selling or transferring assets to the issuer. In addition to risk retention requirements, there would be new disclosure requirements imposed on issuers, most notably one that would obligate securitizers to disclose any fulfilled or unfulfilled repurchase requests across all trusts aggregated by the securitizer.

The “Volcker Rule.” The Conferees included a revised version of the so-called “Volcker Rule” that is designed to limit the ability of “banking entities” (which includes non-bank affiliates of insured depository institutions, i.e., investment banks) and non-bank financial companies supervised by the Federal Reserve to engage in proprietary trading or to own hedge or private equity funds, as modified by the “Merkley-Levin” amendment that had died in the Senate but was re-introduced during the conference. The Merkley-Levin amendment is widely viewed as stricter than Volcker as originally passed by the Senate, because the former included a near immediate ban on proprietary trading and fund investment except as allowed by circumscribed regulation, whereas the latter gave regulators more time and latitude to study the issues and regulate accordingly. Merkley-Levin also raised concern during Senate floor debate because it had a second section explicitly prohibiting conflicts of interest between asset-backed securities underwriters and investors, and which restricted underwriters’ ability to hedge.

The final formulation appears to address the concerns raised by the CRE Finance Council that the proprietary trading ban could have posed a threat to securitization. These concerns are ameliorated because the bill deletes the explicit prohibition on underwriters’ conflicts, and now

- (1) explicitly states that it does not limit or restrict the ability of banks to sell or securitize loans in a manner otherwise permitted by law;
- (2) states that risk-mitigating hedging activities in connection with individual or aggregated positions, contracts, or other holdings are allowed if they are designed to reduce the specific risks to a banking entity in connection with and related to such positions; and
- (3) provides that the purchase, sale, disposition and the like of securities in connection with underwriting and market-making are allowed “to the extent that any such activities permitted by this [exemption provision] are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.”

All permitted activities are, however, subject to rules regulators must develop to limit conflicts of interest between banks and non-bank financial institutions, and their customers.

The issues of significance to the CRE Finance Council are discussed in additional detail below, followed by more summary discussion of other high-profile aspects of the legislation.

ANALYSIS

I. SECURITIZATION REFORM

On the whole, the securitization provisions in the bill drew provisions from both the House and Senate versions that had been priorities for the CRE Finance Council. Fundamentally, the bill imposes a number of new requirements on “securitizers,” entities defined as issuers of ABS or those who organize or initiate an ABS transaction by selling or transferring assets to the issuer. As a preliminary matter, it should be noted that asset-backed securities are defined broadly to include collateralized mortgage obligations, and collateralized debt or bond obligations, as well as collateralized debt obligations of collateralized debt obligations, among other categories. (§ 941(a) (adding Securities Exchange Act § 3(a)(77)).

The regulators charged with developing and enforcing the rules in the non-residential markets are the “banking regulators” (the Federal Reserve, FDIC and OCC for depository institutions) and the Securities and Exchange Commission (“SEC”) for any securitizer that is not a depository institution. The Conference Agreement adds a specification that the Department of Housing and Urban Development (“HUD”) and the Federal Housing Finance Agency (FHFA”) are to participate in the rulemaking along with the banking regulators and SEC for residential mortgage assets. (§ 941(b) (adding Securities Exchange Act § 15G (b)). Notably, the Conference Agreement also adds a provision that authorizes the Chair of the Financial Stability Oversight Council to coordinate all joint rulemakings required under the bill’s risk retention section. (§ 941(b) adding Securities Exchange Act § 15G (g)).

A. Risk Retention and Hedging

As previously mentioned, the bill’s risk retention provision directs regulators to develop separate rules for each category of ABS, including residential mortgages, commercial mortgages, commercial loans, auto loans, and any other category of ABS they deem necessary. A specific provision pertaining to commercial mortgages directs that regulators may allow the risk retention requirement to be satisfied through alternative means that may include retention of a percentage of the credit risk, “underwriting standards and controls” that are “adequate,” or “adequate representations and warranties and related enforcement mechanisms.” ((§ 941(b) (adding Securities Exchange Act § 15G (c)(1)(E)).

Significantly, regulators may also allow retention of risk by a “third-party investor” (in addition to retention by the “securitizer” or “originator” of loans) to satisfy a potential retention mandate for commercial mortgage-backed securities (“CMBS”), so long as the third-party investor purchases a first-loss position for which it specifically negotiates, performs due diligence, and retains this risk in accordance with the statute’s requirements. A criterion added to this list by the Conferees for third-party investors is that they must hold “adequate financial resources to back losses.” (*id.* (adding Securities Exchange Act § 15G (c)(1)(E)(ii)). The purpose of this added qualification was not clearly articulated by the House Conferees who proposed it, although the concern may have been about whether the third party investor could remain fully solvent or sufficiently capitalized to survive the retention period without being forced to transfer the risk. While such a concern would apply equally to issuers and originators,

the Conferees did not suggest the “adequate financial resources” condition for these parties. However, regulators likely have the discretion to apply it to issuers and originators.

The Conference Agreement also adds a separate requirement that retention standards be established for CDOs, securities collateralized by CDOs and similar instruments collateralized by other ABS. (*id.* (adding Securities Exchange Act § 15G (c)(1)(F)).

Generally, retention of a minimum of 5% of the credit risk will be required, unless the transaction meets “underwriting standards” the regulators will develop, which standards will “specify the terms, conditions, and characteristics of a loan within the asset class that indicate a reduced credit risk with respect to the loan,” and which are to be established for each asset class. Where the mandated underwriting standards are met, the minimum retained risk may be “less than 5%” (*id.* (adding Securities Exchange Act § 15G (c)(1)(B)(ii)).¹

And rather than prescribe all permissible forms of risk retention and minimum duration of retained risk, the bill also leaves these tasks to the regulators. (*id.* (adding Securities Exchange Act § 15G (c)(1)(C)).

Hedging of the retained credit risk will be prohibited. (*id.* (adding Securities Exchange Act § 15G (c)(1)(A)).

The bill further specifies that risk retention obligations may be divided between the securitizer and an “originator” (defined as a person who sells assets to a securitizer). In making such determinations, regulators are directed to consider whether the assets in question have characteristics reflecting low risk, the potential impact of risk retention obligations on the availability of credit, and whether the form or volume of transactions in securitization markets creates incentives for imprudent origination of the type of asset to be sold to the securitizer. (*id.* (adding Securities Exchange Act § 15G (d)).

The bill explicitly provides for exemptions and adjustments to be made to the retention and hedging rules for classes of institutions or classes of assets. The standards for granting these latter exemptions are to “help ensure high quality underwriting” and “encourage appropriate risk management practices;” improve access of consumers and businesses to credit; or otherwise be in the public interest and for protection of investors. Certain exemptions are mandated in the bill, namely, for loans or other financial assets made, insured or guaranteed by the Farm Credit Administration including the Federal Agricultural Mortgage Corporation (“Farmer Mac”), and for securitizations and certain types of loans that are issued, insured or guaranteed by the federal government, with the exception of ones from Fannie Mae and Freddie Mac and in certain cases, the federal Home loan banks. (*see id.* (adding Securities Exchange Act § 15G (d)(G) & (e)(3)).

¹ In addition, “qualified” residential mortgages would be exempt from the risk retention mandate, with the banking regulators, SEC, HUD and FHFA being given the authority to define “qualified” mortgages, taking into consideration historical loan performance data indicating lower default risk. (*see id.* (adding Securities Exchange Act § 15G (c)(1)(B)).

The risk retention rules must be jointly prescribed by the banking regulators and the SEC 270 days after enactment, and must go into effect two years after date final rules are published for all asset classes other than residential. The rules for residential must go into effect within 1 year of publication of final rules.

B. New Disclosure Requirements

A number of new disclosure requirements are imposed with respect to ABS. Most notably:

- the SEC must adopt rules requiring securitizers to disclose any fulfilled and unfulfilled repurchase requests across all trusts aggregated by the securitizer (these rules must be adopted within 180 days of enactment) (§ 943(2));
- for any ABS that must be registered with the SEC, the issuer must perform a due diligence analysis of the underlying assets and must disclose the nature of the analysis (these rules must be adopted within 180 days of enactment) (§ 945); and
- issuers will be required to disclose information regarding the assets backing the ABS for each tranche or class of security (§ 942 (b)), including:
 - asset-level or loan-level data necessary for investors to independently perform diligence;
 - data with unique identifiers relating to loan brokers or originators;
 - the nature and extent of broker or originator compensation; and
 - the amount of risk retained by the originator and securitizer of the assets.
- as part of the credit rating agency reform provision, issuers or underwriters must publicly disclose the findings and conclusions of any third-party due diligence report they obtain (§ 932 (a)(8) (adding new Securities Exchange Act § 15E (s)(4)).

The bill also amends the default rule in Section 15(d) of the Securities Exchange Act that suspends the duty to file periodic or supplemental information where a class of registered securities is held by fewer than 300 persons. Instead, for registered ABS, the SEC is directed to determine whether periodic filing obligations will be suspended for particular classes of ABS as necessary or appropriate in the public interest, or it may prescribe particular filing obligations appropriate for each class of issuers (§ 942 (a)). Unless noted above, a timeline is not specified in the bill for adoption of rules to effect these disclosure requirements.

C. Representations and Warranties

As part of the securitization reform provision, the bill directs that NRSROs' credit rating reports must include information on the representations, warranties and enforcement mechanisms

available to investors with respect to the rated ABS, and information on how these representations, warranties and enforcement mechanisms differ from those in issuances of similar securities (§ 943). The SEC must adopt these rules within 180 days of enactment.

D. Studies

Two important studies are required by the bill. Most significantly, regulators will be required to study the combined impact of risk retention mandates and the accounting reforms in FAS 166/167, which study must be completed before any final rulemaking on risk retention. The second study provision requires the Financial Services Oversight Council to study and report on the combined macroeconomic impact of the new securitization reforms and mandates.

II. CREDIT RATING AGENCY REFORM

The credit rating reform provisions largely track those passed in the Senate’s version of the bill. However, the Conference Agreement makes changes to the provision that had been added to the Senate’s version by the Franken amendment, which sought to create a new independent board to assign rating agencies to conduct initial ratings of structured finance products.

A. Assignment of Rating Agencies to Conduct Initial Ratings

As mentioned, the Senate’s version of the bill required the SEC to establish a new independent board that would assign NRSROs to conduct initial ratings of structured finance products, eliminating the current practice of issuers selecting the NRSRO themselves. The stated purpose of this provision was to address conflicts of interest arising from the issuer-pays model of credit ratings, and the provision contained several specific directions for the SEC to follow in establishing this new framework, including specifics on the affiliations of those who would be appointed to the board (e.g., a majority had to be “independent”), directions that the SEC consider whether assignments should be made randomly or on a rotating basis, and a mandate that the SEC figure out how to assess the accuracy of ratings.

There were many twists and turns in the debate over the Franken amendment. The initial proposal offered to strike it in favor of a simple study of conflicts of interest in the present ratings framework. Next, the study language was enhanced to require the SEC to adopt the new independent board rules for initial ratings, followed by another proposal that creation of the new board be made optional after the SEC completed the study. The final language seems to have ended up somewhere between these last two proposals.

The SEC will be required to study several particular aspects of the credit rating process including “conflicts of interest associated with the issuer-pay and subscriber-pay models,” the feasibility of establishing a system for a “public or private utility or self-regulatory organization” to assign NRSROs to do initial ratings, methods for determining fees, metrics for assessing accuracy of ratings, and “the extent to which the creation of such a system would be viewed as the creation of moral hazard by the Federal Government.” (§ 939F (b)). The SEC is to report its findings to Congress within 12 months of enactment. At that point, the bill provides that the SEC “shall” establish the system for assigning NRSROs to do initial ratings, but “as the

Commission deems is necessary or appropriate in the public interest or for the protection of investors.” (§ 939F(d)). The bill further directs that in issuing any rule the SEC “shall give thorough consideration” to the Franken amendment as passed by the Senate (which would include all of its specific directions on establishing the new assignment framework), and “shall implement the system described [in the Franken amendment] unless the Commission determines that an alternative system would better serve the public interest and the protection of investors.” (*Id.*) The degree of discretion left to the SEC is less than clear, but it certainly appears that the bill attempts to dictate what the agency should do without using language that explicitly mandates establishment of the new board.

With respect to the rest of the rating reform framework, the final bill retains the myriad of new oversight, transparency, and reporting requirements for NRSROs that were first adopted by the Senate Banking Committee (which are explained below). Oversight of NRSROs would be vested in a new Office of Credit Ratings within the SEC, and final regulations to implement the new requirements would be required to go into effect one year after enactment.

B. Ratings Differentiation

Tracking the Senate version, there is no requirement that differentiated ratings be used for structured finance products. Indeed, a section entitled “Universal Rating Symbols” requires that each NRSRO establish and maintain written policies that assess the probability of default for a particular instrument and define and disclose the meaning of any symbol the NRSRO uses to denote a credit rating, and must apply any such symbol consistently for all types of securities for which the rating is used. This provision is followed by a “rule of construction” stating that the universal rating symbol provision does not prohibit use of distinct symbols to denote ratings for different types of securities. (§ 938). Given that the bill is structured to lead with the “Universal Ratings Symbols” provision followed by the relative “aside” that distinct symbols are not prohibited, the bill may be read to preclude the SEC from mandating differentiated symbols while leaving the choice to individual NRSROs.

C. Oversight

NRSROs would be required to maintain internal governance and control structures and file annual reports with the SEC concerning the operation and effectiveness of their internal controls. They would be required to prevent marketing and sales considerations from influencing ratings by separating these functions. And they would be subject to annual examinations by the SEC. An NRSRO’s registration would be subject to suspension or revocation with respect to a particular class or subclass of securities if the agency determines that the NRSRO lacks “adequate managerial or financial resources to consistently produce credit ratings that are accurate.” (§ 932) And the SEC would be required to establish qualification standards for credit rating analysts (§ 936).

The Conference agreement adds a “Sense of Congress” provision suggesting that the SEC adopt rules to “prevent improper conflicts of interest” arising from NRSROs providing issuers with consulting services unrelated to ratings; a one year look-back at the ratings of credit analysts who are involved in ratings and then go work for the issuers who obtained the rating;

and a requirement of reports to the SEC regarding NRSRO employees who go to work for the issuers whose products they rated. (§ 932 (a)(4)).

D. Transparency of Ratings

Each NRSRO would be required to publicly disclose information on initial credit ratings and any subsequent changes to allow users of credit ratings to evaluate their accuracy and compare performance to ratings of other NRSROs. (§ 932 (a)(8) (adding Securities Exchange Act § 15E (q))). The SEC must also require each NRSRO to ensure that ratings methodologies are approved by the NRSRO's board and are followed by the organization, and ensure that any changes are applied consistently and are publicly disclosed, and ensure that errors are publicly disclosed. In addition, the SEC will develop a form to be used by NRSROs to disclose assumptions underlying methodologies, data relied upon to determine ratings and conduct surveillance, and any other information that can be used by investors to understand the ratings. (§932 (a)(8) (adding Securities Exchange Act § 15E (r)-(s))). And if any third-party due diligence services are used by the NRSRO, the third party must provide the rating entity with a certification stating that the third party conducted a thorough review of data, documentation or other material necessary for the NRSRO to provide an accurate rating. Information about third-party due diligence must also be publicly disclosed with the rating. (§932 (a)(8) (adding Securities Exchange Act § 15E (s)(4))).

Moreover, NRSROs would be obligated to consider credible information about an issuer that the NRSRO has or obtains from a third party if the information would be “potentially significant” to a rating decision. (§ 935)

E. Liability and Reporting Issuer Violations

A private right of action would be created to allow suits against credit rating agencies for a knowing or reckless failure to conduct a reasonable investigation of the facts or to obtain analysis from an independent source (§ 933). NRSROs would also have an affirmative obligation to report suspected legal violations on the part of issuers being rated by the NRSRO. (§ 934)

F. Studies

Several studies of issues related to credit rating would be mandated by the bill:

- The SEC would be directed to study the feasibility and desirability of standardizing credit ratings terminology (including across all asset classes) so that all NRSROs issue ratings using identical terms, standardizing the market stress conditions under which ratings are evaluated, and requiring a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations under standardized conditions of economic stress. The SEC must report the results of this study to Congress within one year of enactment of the Dodd-Frank legislation. (§ 939(h));

- Federal agencies would be given one year from the date of enactment of Dodd-Frank to review their regulations, and remove references to credit ratings unless there is no reasonable alternative (§ 939A);
- The SEC would be directed to study the independence of NRSROs, how independence impacts ratings, and the potential impact of prohibiting a rating NRSRO from providing an issuer with other services, as well as providing recommendations on improving ratings integrity. This study must be completed within three years of the date of the Dodd-Frank legislation’s enactment. (§ 939C);
- The GAO would be directed to study alternative means of compensating NRSROs to provide more accurate ratings, which study must be completed no later than 18 months after enactment of Dodd-Frank. (§ 939D); and,
- The GAO would be directed to study the feasibility and merits of creating an independent professional organization to regulate ratings analysts, and report its findings to Congress within one year of the Dodd-Frank legislation’s enactment. (§ 939E).

III. “VOLCKER RULE” LIMITS ON PROPRIETARY TRADING & OTHER ACTIVITIES

The highly controversial “Volcker Rule” is designed to curb risk-taking by insured depository institutions by limiting their ability to engage in proprietary trading and their ability to own or sponsor hedge or private equity funds. The rule, as adopted by the Conferees, includes modifications made to the original Senate-passed version by the “Merkley-Levin Amendment.” That amendment had died in the Senate but was re-introduced during the conference.

The Merkley-Levin amendment is widely viewed as stricter than the original version of the Volcker Rule because the former includes a near immediate ban on proprietary trading and fund investment except as allowed by circumscribed regulation, whereas the latter gave regulators more time and latitude to study the issues and regulate accordingly. Merkley-Levin also raised significant concern for the securitization industry during Senate floor debate because the amendment had a second section explicitly prohibiting conflicts of interest between asset-backed securities underwriters and investors, and which restricted underwriters’ ability to hedge. Such limitations were exacerbated by the fact that the Merkley-Levin amendment covered not only insured depository institutions, but “banking entities,” which encompasses non-bank affiliates of insured depository institutions such as investment banks. (The amendment also covers non-bank financial companies supervised by the Fed).

The final formulation as reflected in Section 619 of the bill appears to address the concerns raised by the CRE Finance Council that the proprietary trading ban could threaten securitization. These concerns are ameliorated because the bill deletes the explicit prohibition on underwriters’ conflicts, and now –

- (1) explicitly states that it does not limit or restrict the ability of banks to sell or securitize loans in a manner otherwise permitted by law;
- (2) states that risk-mitigating hedging activities in connection with individual or aggregated positions, contracts, or other holdings are allowed if they are designed to reduce the specific risks to a banking entity in connection with and related to such positions; and
- (3) provides that the purchase, sale, disposition and the like of securities in connection with underwriting and market-making are allowed “to the extent that any such activities permitted by this [exemption provision] are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.”

(§ 619 (new Bank Holding Company Act § 13 (d)(1) & (g)(2)). All permitted activities remain subject, however, to rules regulators must develop to limit conflicts of interest between banking entities and their customers. (*Id.* (new Bank Holding Company Act § 13 (d)(2)).

IV. OTHER REFORM PROVISIONS

The massive bill contains monumental changes to other aspects of the nation’s financial system. Among the highlights, the legislation:

- Creates a new “Financial Stability Oversight Council” which would be located in the Federal Reserve and identify nonbank financial companies that should be subject to enhanced regulation (Title I).
- Provides new powers to the FDIC to wind-down (or “resolve”) financial institutions that are systemically significant (Title II).
- Creates a new “Bureau of Consumer Financial Protection” within the Federal Reserve that would be charged with regulating consumer loan oriented and related products (Title X).
- Creates a new Federal Insurance Office (FIO) to house federal insurance industry expertise and to be the lead federal representative with respect to international insurance-related regulatory commitments (Title V).
- Adopts numerous new investor protection provisions (Title IX).
- Imposes new executive compensation and corporate governance rules on publicly traded companies (Title IX).
- Expands the regulation of the over-the-counter derivatives market (Title VII).

- Provides grants to states to address misleading and fraudulent marketing practices aimed at seniors (Title IX). And,
- Imposes new SEC obligations on hedge funds and other private money managers (Title IV).

A. Systemic Risk: Financial Services Oversight Council

The bill creates a Financial Stability Oversight Council (the “Council”) of regulators to monitor the financial system for companies that have become so large or interconnected that their failure could threaten the economy, and recommend that such companies be subject to heightened supervision by the Federal Reserve. There are no industry exclusions from the process. However, and as discussed below, the bill includes a number of risk-based criteria to be used by the Council to make the determination.

The ten voting members of the Council include the Treasury Secretary (to serve as permanent Council Chair); the chairman of the Federal Reserve; the Comptroller of the Currency; the chairman of the SEC; the chairman of the Commodity Futures Trading Commission (CFTC); the chairman of the FDIC; the director of FHFA; the director of the new Bureau of Consumer Financial Protection; an insurance representative appointed by the President; and the chairman of the National Credit Union Administration (NCUA) Board. Five nonvoting members of the Council include: the director of the Office of Financial Research; the director of the Federal Insurance Office; a state insurance commissioner designated by a selection process determined by the state insurance commissioners; a state banking supervisor designated by a selection process determined by the state banking supervisors; and a state securities commissioner designated by a selection process determined by the state securities commissioners. (§111)

The Council is responsible for identifying nonbank financial companies that should be subject to “heightened prudential standards” by the Federal Reserve. Upon the vote of 2/3 of the Council, including the Council Chairman (the Treasury Secretary), that a company would pose a threat to the financial stability of the United States, a nonbank financial company would be subject to Federal Reserve supervision and enhanced prudential standards. (§113)

In order to secure information necessary to identify systemically important companies, the Council is authorized to obtain information about any nonbank financial company or bank holding company to assess the extent to which the company’s financial activity – or the financial market in which the entity participates – poses a threat to the financial stability of the United States. The Council will obtain information from its member agencies, other federal and state financial regulatory agencies, and the Federal Insurance Office, as well as the Office of Financial Research, which is specifically authorized to require reports from bank holding companies and nonbank financial companies. To minimize reporting burdens, the Council and the Office are required to go through the primary financial regulatory agencies to secure relevant information before requesting reports directly from companies. There are confidentiality, data security and privilege protections that the Office and Council must observe in the collection of data. (§112)

If the information provided in the reports is inadequate to make a determination as to systemic risk, the Council can request the Federal Reserve to conduct an examination of the company. (§112)

The Council is also tasked with monitoring the financial services marketplace to identify potential threats to the country's financial stability; monitoring domestic and international financial regulatory proposals and developments and making recommendations to Congress; facilitating information sharing among Council members and federal and state agencies; identifying potentially problematic gaps in regulation; identifying systemically important institutions to be regulated by the Federal Reserve; and making recommendations to the Federal Reserve and to primary financial regulators with respect to heightened prudential standards for systemically important institutions. The Council is required to report annually to Congress and each Council member is required to sign the report or explain why the report (or the Council's work) is lacking. (§112)

Companies that received TARP funds are required to be treated as nonbank financial companies supervised by the Federal Reserve, whether or not they meet the qualifications of a systemically important company as set forth in the bill. (§117)

1. Determination of systemically important nonbank financial companies

In making a systemic risk determination regarding a company, the Council must consider a number of factors, including:

- the degree of leverage of the company;
- the amount and nature of the company's assets;
- the amount and types of liabilities, including the degree of reliance on short-term funding;
- the extent and type of off-balance sheet exposures of the company;
- the extent and type of the company's transactions and relationships with other significant financial companies (bank and nonbank);
- the importance of the company as a source of credit for households, businesses and state and local governments, and a source of liquidity for the US financial system;
- the importance of the company as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of the company would have on the availability of credit in such communities;
- the operation of or ownership interest in any clearing, settlement, or payment business of the company;

- the extent to which assets are managed rather than owned by the company and ownership of assets under management is diffuse;
- the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;
- the degree to which the company is already regulated by one or more primary financial regulatory agencies; and
- any other risk-related factors that the Council deems appropriate. (§113)

There is no requirement that the structure of a financial company be considered in terms of the extent to which the company engages in financial activities solely at the subsidiary level or at both the subsidiary and holding company levels. There are, however, processes in the bill to ensure companies that should be subject to heightened supervision cannot evade Council recommendation and Federal Reserve supervision. (§113)

The Council is required to provide notice to a nonbank financial company that the Council proposes be subject to enhanced prudential supervision. The company may request an oral or written hearing before final determination is made. The bill provides for an expedited process in emergency situations. (§113)

Designation of a nonbank financial company as systemically important and subject to enhanced supervision must be reevaluated by the Council annually. The Council can rescind a company's designation by a 2/3 vote (including that of the Chair). (§113)

A company must register with the Federal Reserve within 180 days of a Council determination that the company is systemically important and should be subject to Federal Reserve supervision. (§114)

The Federal Reserve is required to put stricter standards in place for financial holding companies deemed to pose systemic risk. The Federal Reserve can act on its own (§165) or in accordance with Council recommendations (§115). The supervisory standards are to increase in stringency as companies pose greater risk. The requirements are to be in a number of areas, including:

- Risk-based capital requirements;
- Leverage limits;
- Liquidity requirements;
- Concentration limits;
- Contingent capital requirements;
- Short-term debt limits;
- Resolution plan and credit exposure requirements;
- Enhanced public disclosures; and
- Risk-management requirements. (§§115 and 165)

The Federal Reserve is also mandated to require each publicly traded company that it supervises to establish a resolution plan and a risk committee responsible for oversight of enterprise-wide risk management practices. The risk management committees are to have independent directors (as specified by the Federal Reserve) and a risk management expert on their boards of directors. (§165)

The Council is authorized to give formal recommendations to primary financial regulators, including recommendations that an existing regulator adopt stricter standards to reduce systemic risks. The bill establishes a framework for the agencies to notify the Council of the steps taken in response, or the reason it has failed to respond to the request. The Council is required to report to Congress with respect to compliance by primary regulators with this provision. (§120)

If a bank holding company with more than \$50 billion in consolidated assets or a nonbank financial company supervised by the Federal Reserve is determined to pose a “grave threat” to the financial stability of the United States (by a 2/3 vote of the Council), the Federal Reserve is authorized to modify terminate activities in which the company is engaged, impose conditions on the manner in which the company conducts activities, or sell, divest, or otherwise transfer assets, or off-balance sheet items to unaffiliated companies, essentially breaking up the firm. The bill sets out a process for such action, including notice and hearing upon request by the company. (§121)

2. *Office of Financial Research*

The bill creates a new Office of Financial Research (OFR) in the Treasury Department to collect the reports and other information for use by the Council. (§152) The primary purpose of the OFR is to collect information and evaluate the extent to which a financial product, institution, or company poses a threat to U.S. financial stability. The OFR is also responsible for standardizing the types and formats of data reported and collected; performing applied and long-term research; developing tools for risk measurement and monitoring; and providing information and resources to Council member agencies. The bill grants the OFR limited rulemaking authority in connection with establishing the standardized types and formats for data reporting and collection. (§153)

After the initial 2-year period establishing the OFR, the OFR will be funded through assessments on large bank holding companies (those with consolidated assets over \$50 billion), and nonbank financial companies supervised by the Federal Reserve. (§155)

B. *Resolution Authority*

The legislation gives the FDIC resolution authority over systemically important financial companies (so-called “covered financial companies”) that are in default or in danger of default. (§203)

Before a company becomes subject to federal resolution authority, the Federal Reserve Board and the FDIC (or SEC if the identified financial holding company or an affiliate thereof is

a broker dealer (and is not a depository institution)) by a 2/3 vote must recommend that the Treasury Secretary make a determination that:

- the company is in default or in danger of default;
- the failure of the company and its normal resolution under otherwise applicable federal or state law would have serious adverse effects on U.S. financial stability;
- there is no viable private sector alternative to prevent default;
- the effect of FDIC resolution on the claims or interests of creditors, counterparties and shareholders of the company and other market participants is appropriate given the serious destabilizing effects of a company failure on U.S. financial stability; and
- federal resolution would avoid or mitigate adverse affects on US financial stability;
- a federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments that are subject to the regulatory order. (§203)

In addition, the Treasury Secretary is required to petition the US District Court for the District of Columbia for an order authorizing the appointment of the FDIC as receiver. The court's decision may be appealed to the U.S. Court of Appeals for the D.C. Circuit and, ultimately, the U.S. Supreme Court. (§202)

As set forth in the legislation, the FDIC's receivership powers appear to be very similar to the FDIC's current authority with respect to depository institutions. (§204)

The House effort to create a \$50 billion pre-event "orderly liquidation" fund failed, so any assessments imposed to cover the costs of a resolution will be post-event. First to be assessed will be the claimants that received more under the resolution process than they would have in an ordinary bankruptcy process. If the amount collected from those claimants is insufficient, assessments can be imposed on (1) "eligible financial companies," which are bank holding companies with \$50 billion or more in total consolidated assets and nonbank financial companies supervised by the Federal Reserve under section 113, and (2) other financial companies (not subject to Fed supervision) with total consolidated assets over \$50 billion.

The additional assessments are weighted according to a risk matrix, recommended by the Council and implemented by the FDIC, that takes into account factors such as assets, activities, leverage, liquidity risk, and funding sources, as well as a 10-year "look back" to determine whether the assessed financial company presented any risks that contributed to the failure of the institution under FDIC receivership. (§204(o))

C. Bureau of Consumer Financial Protection

The legislation would create a Bureau of Consumer Financial Protection within the Federal Reserve that will assume the consumer protection authority of many of the federal financial services agencies under existing federal financial consumer protection laws. (Title X)

The bill would give the Bureau authority to promulgate rules and enforce the consumer protection provisions of a number of “enumerated” federal consumer protection laws currently under the jurisdiction of existing agencies, including the Fair Credit Reporting Act (FCRA), the Real Estate Settlement Procedures Act (RESPA) and the privacy provisions of the Gramm-Leach-Bliley Act (GLBA). Persons subject to any of the “enumerated laws” are subject to Bureau authority to the extent the enumerated laws are currently enforced at the federal level. State enforcement authority is preserved, however. For example, the bill gives the Bureau general enforcement authority over the privacy provisions of the GLBA, but the states retain enforcement authority with respect to the insurance sector. (§§ 1027 and 1041)

It is important to note that Bureau authority is limited to consumer financial products and services for personal, family or household use, not commercial products and services. (§1002)

Persons regulated by the SEC, state securities regulators, and the CFTC are exempt from Bureau authority, as are persons regulated by state insurance regulators. (§1027)

The Bureau will be headed by a Director appointed by the President for a term of 5 years. The Director would wield all executive and administrative powers of the Bureau. Although located in the Federal Reserve, the Bureau is independent of the Federal Reserve in all areas but funding (the Fed funds the Bureau). The bill sets forth the corporate and administrative powers and structure of the Bureau, and requires creation of a research unit, a community affairs unit, a consumer complaints collection and tracking unit, an Office of Fair Lending and Equal Opportunity, an Office of Financial Education, an Office of Service Member Affairs, an Office of Financial Protection for Older Americans, and a consumer advisory board. (Title X, Subtitles A and B)

The legislation gives the Bureau authority to implement and enforce the provisions of the federal consumer financial laws that are set forth in the title, including exclusive rulemaking authority. The Bureau is required to consult with the prudential regulators to ensure consistency with prudential, market and systemic objectives. Prudential regulators may comment on proposed rules, and the Financial Stability Oversight Council may stay and/or set aside a Bureau-promulgated rule if it is determined that the rule would put the safety and soundness of the U.S. banking system or the stability of the U.S. financial sector at risk. (Title X, Subtitles B and F)

The Bureau can require reports and conduct examinations of covered entities that are not banks, as well as very large banks and credit unions (those with over \$10 billion in total assets). Some consultation with primary regulators is required, but the Bureau has significant rule-writing and enforcement authority over these entities. The Bureau has significantly less authority over banks and credit unions with less than that amount in total assets, where reliance on their primary regulator is greater. (Title X, Subtitle B)

The bill transfers all consumer financial protection functions of the federal banking agencies to the Bureau. This includes the consumer financial protection authority of the Federal Reserve, the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration (NCUA). Federal Trade Commission (FTC) authority has ping-ponged back and forth, but in the final conference bill, the FTC loses less authority to the Bureau than do the other agencies. The conference bill transfers to the Bureau only the authority to issue rules, guidelines and reports in connection with the “enumerated consumer laws.” The FTC retains authority to enforce the rules. The Bureau is given authority to enforce unfair/deceptive acts or practices under the FTC Act. This is additional enforcement authority – the FTC retains unfair/deceptive act enforcement authority. (Title X, Subtitle F)

The bill would preempt state laws only to the extent they are inconsistent with the bill, and specifically provides that state laws and regulations that provide greater protections for consumers are not necessarily inconsistent with the bill. Moreover, the bill permits state attorneys general to bring civil actions under the bill (except with respect to national banks and federal thrifts). (Title X, Subtitle D)

D. Federal Insurance Office

The bill would create a Federal Insurance Office (FIO) within the Treasury Department. (Title V, Subtitle A) The Office will be headed by a Director appointed by the Treasury Secretary. The bill authorizes FIO to:

- monitor the insurance industry to gain federal expertise in insurance, consult with the states regarding national and international insurance matters, and advise Treasury on domestic and international insurance issues;
- along with the US Trade Representative, Treasury is authorized to negotiate and enter into “covered agreements” on behalf of the US; a “covered agreement” is an international agreement on insurance matters between the US and a foreign government that deals with prudential/regulatory matters;
- identify issues/gaps in the regulation of insurers that could pose systemic risks and recommend to the Financial Stability Oversight Council the designation of any insurer that should be subject to systemic regulatory oversight;
- administer TRIA;
- coordinate federal efforts and develop federal policy on international insurance matters, including representing the US at the International Association of Insurance Supervisors (IAIS) and assisting in negotiation of certain international agreements;
- monitor the extent to which traditionally underserved communities and consumers, minorities and low- and moderate-income persons have access to affordable insurance products; and,

- preempt state laws. (§502)

The FIO's authority covers all lines of insurance except health insurance, long-term care insurance, and crop insurance. Within 18 months of enactment, the bill requires FIO to conduct a study and submit a report to Congress on how to "modernize and improve" the system of insurance regulation in the U.S., including an analysis of capital standards, consumer protection and the costs and benefits of potential Federal regulation across lines of insurance.

E. New Investor Protection Provisions

1. Broker-Dealer Fiduciary Duty

Rather than impose a fiduciary duty on broker-dealers, either under the Securities Exchange Act of 1934 (as in the House-passed bill) or as part of a broader registration requirement under the Investment Advisers Act of 1940 (as in Chairman Dodd's earlier proposal), the Dodd-Frank bill includes a provision requiring the SEC to conduct a broad-based study of the legal and regulatory protections in place for investors under the Securities Exchange Act of 1934 and the Investment Adviser Act of 1940, including the current standards of care imposed on brokers, dealers, investment advisers, and persons associated with them when they provide personalized investment advice and recommendations about securities to customers. Once the study is complete, the SEC is directed to promulgate rules to address any gaps in consumer protection revealed by their findings. If the SEC does not have existing authority to promulgate rules to address the issues raised, the SEC would need to request additional authority from Congress. (§913)

2. Senior Investor Protection

The investor protection provisions of the bill also address the so-called "senior designations" issue. These provisions address Congressional concerns that seniors are allegedly being targeted by salespersons who use misleading certifications and designations that imply a level of knowledge or training that the adviser does not, in fact, possess.

The bill establishes a program by which states can apply for and receive grants to investigate and prosecute misleading and fraudulent marketing practices aimed at seniors. (§989A) Grants under this program would be limited to \$100,000 or \$500,000 per year for three years. States can receive grants for renewable three-year periods. Funds can be used to fund staff to identify, investigate and prosecute cases involving misleading or fraudulent marketing of financial products to seniors; to fund technology, equipment and training for regulators, prosecutors and law enforcement officials; to provide educational materials and training to regulators and to seniors; and to develop plans to combat misleading or fraudulent marketing of financial products to seniors.

3. Asset Threshold for Investment Adviser Registration

The bill increases the asset threshold for investment advisers who are required to register with the SEC (as opposed to state securities regulators). Currently, investment advisers with assets under management over \$25 million are required to register with the SEC. Under the

conference bill, that threshold will increase to \$100 million. This will effectively reduce the number of investment advisers subject to SEC oversight, and could have an impact on the ability of the SEC to implement more hands-on regulation of advisers.

4. Investor Advisory Committee

The bill creates two new entities within the SEC designed to provide investors with greater access and input. The bill establishes an Investor Advisory Committee to advise the SEC on issues relating to securities products, trading strategies, fee structures and disclosure, as well as investor-directed initiatives. The Committee is authorized to make recommendations to the SEC as necessary, including suggestions for proposed legislation. The members of the Committee are to include the Investor Advocate, a representative of state securities regulators, a representative of the interests of seniors, and 10 – 20 other members representing the interests of investors in equity and debt securities and institutional investors (but no industry representation). The SEC is required to review and assess the recommendations of the Committee and make public any action based on Committee recommendations. (§911)

5. Investor Advocate

The bill also creates an Office of Investor Advocate at the SEC. (§915) The Investor Advocate would be appointed by and report directly to the SEC Chairman. The principal functions of the Investor Advocate are to assist investors in resolving “significant” problems with the SEC or self-regulatory organizations (such as FINRA); identify changes to SEC and SRO rules that would benefit investors; identify investor problems with financial service providers and products; review proposed SEC and SRO rules regarding their impact on investors; and propose changes to the SEC and Congress to address such problems. The Investor Advocate would have full access to SEC and SRO documents, presumably confidential documents as well as public documents, and be required to report annually to Congress on its activities and proposals for administrative and legislative changes to resolve problems encountered by investors.

6. SEC Authority To Require Investor Disclosures

The bill includes a provision “clarifying” the SEC’s current authority to issue rules designating documents or information that a broker-dealer must provide to a retail investor before the purchase of an investment product or service by the retail investor. (§919) The provision does not require the SEC to issue such a rule, but if it does, the disclosure required under the rule must be in “summary” format, and include information on investment objectives, strategies, costs and risks, as well as compensation or “other financial incentives” received by the broker-dealer for the sale.

This is not new authority for the SEC, but merely clarifies authority that the SEC currently holds, which begs the question as to why it is necessary. Presumably it indicates that the SEC is considering issuing disclosure rules at some point in the future.

F. Executive Compensation

As part of the investor protection provisions in Title IX, the bill would impose new executive compensation and corporate governance requirements on public companies. The major components of the executive compensation framework are “say on pay,” independent compensation committees, claw back of incentive-based pay, disclosure requirements, and special limits for banking institutions.

1. “Say on Pay”

Starting six months after enactment, public companies would be required to have a non-binding shareholder vote on compensation for those executives whose compensation must be disclosed under SEC rules. Such a vote must be conducted at least once every three years, and there must be a separate vote at least once every six years on the frequency of say-on-pay votes and whether they will be held every 1, 2, or 3 years. (§ 951 (adding Securities Exchange Act § 14A (a)). There is a separate requirement for a vote on golden parachutes associated with mergers or similar transactions, a concept that came from the House-passed version. (*Id.* (adding Securities Exchange Act § 14A (b))). And there is a requirement that institutional investors publicly report their say-on-pay votes, which also came from the House. (*Id.* (adding Securities Exchange Act § 14A (d))).

The bill explicitly provides that the non-binding shareholder votes cannot be construed as overruling any decision by the board of directors and do not imply any additional fiduciary duty by the board.

The SEC will be given the authority to promulgate rules to implement the say-on-pay requirements, including some limited ability to exempt categories of public companies (e.g., small companies) from say-on-pay requirements. (*Id.* (adding Securities Exchange Act § 14A (e))).

2. Independent Compensation Committee Requirement

Public companies with compensation committees must have only independent directors on those committees. Factors to be considered by regulators in determining whether a director is “independent” include sources of the director’s compensation and any affiliations with the reporting entity or its subsidiaries. (§ 952 (adding Securities Exchange Act § 10C (a))).

The bill also requires that any compensation consultant or other similar advisor, as well as counsel or other advisors that are hired by a compensation committee, must be “independent” in accordance with standards to be developed by the SEC. These standards must consider factors including the provision of other services to the reporting entity by the consultant or legal counsel, the amount of fees received by the consultant or counsel as compared to their total revenue and any stock owned in the reporting entity, conflict of interest policies maintained by the consultant or counsel, and any business or personal relationship the consultant or counsel has with a member of the compensation committee. These standards also must be “competitively neutral among categories of consultants, legal counsel, or other advisors,” to preserve the ability of compensation committees to retain the services of members of any such category. (§ 952 (adding Securities Exchange Act § 10C (a))).

Compensation committees must be given the direct responsibility for and oversight of their consultants and counsel. Moreover, the compensation committee is allowed to determine the amount of funding it needs to pay its independent consultants and counsel, and issuers “shall provide” this funding. Public companies will be required to disclose in annual meeting material whether the compensation committee retained an independent compensation consultant, and whether there are any conflicts of interest with such consultants and how such conflicts are being addressed. (*Id.* (adding Securities Exchange Act § 10C (c))).

The SEC is directed to promulgate rules to effect the compensation committee requirements, and must direct that any non-compliant public entity be prohibited from having its equity securities listed on a national securities exchange or association. This directive must be made within 360 days of enactment. As is the case with the say-on-pay requirement, the SEC will have authority to provide exemptions from these requirements. (§ 952 (adding Securities Exchange Act § 10C (a))).

3. Claw Back of Incentive-Based Pay

Public companies will be required to establish policies providing that in the event the company is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws, the company will recover incentive-based compensation from any current or former executives that was awarded based on the erroneous data, that was in excess of what would have been paid under the restatement. The claw back period extends for three years. (§ 954 (adding Securities Exchange Act § 10D)).

4. Disclosures

The new disclosures required with respect to executive compensation are the following:

- Public companies will be required to disclose in annual proxy statements all compensation required to be disclosed by SEC rules, including information showing the relationship between executive compensation and financial performance (which may be presented in the form of a chart), and a comparison of CEO pay to the median for all employees (§ 953);
- Public companies will be required to disclose their policies for payment of incentive-based compensation that is based on financial information that must be reported under the securities laws (§ 954); and,
- The companies will be required to disclose in their annual proxy statement whether any employee or director is permitted to hedge securities granted as part of their compensation or held by them (§ 955).

5. Special Limits for Banking Institutions

The Federal Reserve Board is directed to adopt rules prohibiting any compensation plan that provides officers and employees of bank holding companies with “excessive compensation, fees, or benefits,” or could “lead to a material financial loss” for the institution. In developing

these rules, the Federal Reserve Board is directed to consider the compensation standards in Section 39(c) of the Federal Deposit Insurance Act (which includes considerations such as the combined value of all compensation to the individual, the individual's compensation history, the institution's financial condition, and compensation practices at comparable institutions. The Board must adopt these rules within 180 days of the date for transfer of powers and duties established by Section 311 of the bill (within one year of enactment unless the relevant agencies request an extension).

G. Corporate Governance

The Conferees' bill largely adopts the corporate governance requirements that were part of the Senate bill but not part of the House's bill. While much of the debate on corporate governance centered on a proposal to limit proxy access to shareholders that have owned not less than 5% of outstanding shares for not less than 2 years, that restriction appears to have been eliminated, and the Conference Report states only that the SEC must issue rules providing shareholders with proxy access to nominate directors (§ 971). The Conference Agreement retains a requirement that public companies explain, in annual proxy materials, the decision to select the same person, or different persons, to serve as board chairman and chief executive officer (§ 972).

Finally, it appears that Conferees struck a provision that would have required directors in an uncontested election to receive a majority of votes, and required resignation of any director who failed to win a majority unless the Board opted not to accept the resignation.

V. THE "PAY FOR" – THE FINANCIAL CRISIS ASSESSMENT AND FUND

The Conference Agreement initially included a controversial provision that would impose a special assessment on financial firms with over \$50 billion in consolidated assets and hedge funds with over \$10 billion in assets, to raise \$19 billion to offset the cost of the legislation. This "bank tax" gave rise to a dispute which led to the unusual step of re-opening of the conference process, to craft a compromise that would help Democratic leaders round up a few more critical votes for the legislation.

The compromise reached by the Conferees will replace the bank tax with an increase in the FDIC premium ratio from 1.15 to 1.35, and will end the TARP program early so that \$11 billion from that program can be redirected to help make the regulatory overhaul bill budget neutral.

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