



## The Dodd-Frank Act: a cheat sheet

**THE DODD-FRANK  
WALL STREET REFORM  
AND CONSUMER  
PROTECTION ACT,  
OR DODD-FRANK  
ACT, REPRESENTS  
THE MOST  
COMPREHENSIVE  
FINANCIAL  
REGULATORY REFORM  
MEASURES TAKEN  
SINCE THE GREAT  
DEPRESSION.**

The Dodd-Frank Act implements changes that, among other things, affect the oversight and supervision of financial institutions, provide for a new resolution procedure for large financial companies, create a new agency responsible for implementing and enforcing compliance with consumer financial laws, introduce more stringent regulatory capital requirements, effect significant changes in the regulation of over the counter derivatives, reform the regulation of credit rating agencies, implement changes to corporate governance and executive compensation practices, incorporate the Volcker Rule, require registration of advisers to certain private funds, and effect significant changes in the securitization market. Although the legislation calls for a number of studies to be conducted and requires significant rule-making, we all will be required to be intimately acquainted with the Dodd-Frank Act.

In the pages that follow, we summarize the principal aspects of the Dodd-Frank Act. As lawyers, we would reflexively say that this is a summary, and only a very brief summary at that, and that all of this is qualified in its entirety by reference to our more complete (and far longer) descriptions and analyses....As people who receive lots of summaries, we would say short is usually better. We hope you'll find these short summaries useful.

Numerous government agencies are responsible for regulating financial institutions. Commentators have noted that without a governing body to oversee the various agencies, we remain vulnerable to regulatory gaps and oversight failures. The Dodd-Frank Act creates the Financial Stability Oversight Council (“Council”) to oversee financial institutions.

### Creation of the Council

- Chaired by Secretary of Treasury
- Voting members consist of heads of the Treasury, Federal Reserve, OCC, SEC, CFTC, FDIC, FHFA, NCUA, and the Bureau of Consumer Financial Protection (“Bureau”), as well as an independent member with insurance expertise appointed by the President and confirmed by the Senate
- Non-voting members include the director of the Office of Financial Research, the director of the Federal Insurance Office, a state insurance commissioner, a state banking supervisor, and a state securities commissioner

### Purpose of the Council

- Identifying risks to U.S. financial stability that may arise from ongoing activities of large, interconnected financial companies as well as from outside the financial services marketplace
- Promoting market discipline by eliminating expectations of government bailouts
- Responding to emerging threats to financial stability

### Duties of the Council

- Collect information necessary to assess risks to the U.S. financial system
- Provide direction to the Office of Financial Research to support the work of the Council
- Monitor the financial services market place and identify potential threats to U.S. financial stability, as well as regulatory proposals affecting integrity, efficiency, competitiveness, and stability of the U.S. financial markets
- Facilitate information sharing and coordination among member agencies and other federal and state agencies
- Recommend to the member agencies general supervisory priorities and principles reflecting the outcome of discussions among the member agencies
- Identify gaps in regulation that could pose risks to the financial stability of the U.S.
- Require Federal Reserve supervision for nonbank financial companies that may pose risks to U.S. financial stability in the event of their material financial distress or failure
- Review and submit comments to the SEC and any standard-setting body

with respect to an existing or proposed accounting principle, standard, or procedure

- Provide a forum for discussion and analysis of emerging market developments and financial regulatory issues, and to resolve jurisdictional disputes among members of the Council
- Provide an annual report and testimony before Congress regarding financial stability
- Recommend heightened prudential standards for nonbank financial companies and large, interconnected bank holding companies supervised by the Federal Reserve
- Recommend to primary financial regulatory agencies new or heightened standards and safeguards for activities that increase risks of significant liquidity, credit, or other problems spreading among bank holding companies, nonbank financial companies, and U.S. financial markets
- Identify systemically important financial market utilities and payment, clearing, and settlement activities, and require such utilities and activities to be subject

to standards established by the Federal Reserve

### **Other**

- Creates the Office of Financial Research, which will support the Council through data collection and research
- Financial companies and nonbank financial companies can appeal Council requirement to implement stricter standards
- Council must conduct a study on feasibility, benefits, costs, and structure of a contingent capital requirement for nonbank financial companies
- Council must make recommendations to the Federal Reserve and other federal regulators regarding concentration limits, public disclosures, credit exposure, maintenance of long-term hybrid debt convertible to equity and general financial information reports
- If the applicable agency chooses not to implement any recommendation provided by the Council, it must provide a report explaining its rationale



The various government agencies regulating the financial industry with their varying rules and standards led to certain entities not being regulated at all, with others subject to less oversight than their peer financial firms organized under different charters. The Dodd-Frank Act overhauls the existing agency oversight system as described below.

## Major Agency Changes

- Creation of the Financial Stability Oversight Council (Council)
- Creation of the Office of Financial Research within the Treasury to support the Council
- Creation of an independent Bureau of Consumer Financial Protection (Bureau) within Federal Reserve
- Creation of the Office of National Insurance within the Treasury
- Creation of the Office of Credit Rating Agencies within the SEC
- holding companies; Federal Reserve will continue to regulate State member banks
- The OCC will regulate national banks and federal thrifts of all sizes, and will have all rulemaking authority relating to thrifts
- The FDIC will regulate state thrifts of all sizes
- The OTS will be eliminated, all OTS functions, powers, authorities, rights and duties will be transferred to the Federal Reserve, the OCC, or the FDIC
- The SEC will require registration of hedge funds that manage over \$100 million as investment advisers; threshold for investment advisers subject to federal regulation to be raised from \$25 million to \$100 million
- Federal Reserve will regulate thrift holding companies and subsidiaries of thrift holding companies, and will have all rulemaking authority relating to thrift

## Major Changes in Agency Oversight

- The SEC will require registration of municipal financial advisers, swap advisers and investment brokers; Municipal Securities Rulemaking Board rules to be enforced by the SEC
- required to periodically submit “living wills” to regulators in the event of financial distress
- Federal Reserve will be subject to a one-time GAO audit of the Federal Reserve’s lending facilities

### **Other**

- Regulators will be required to implement regulations that prohibit banks, bank holding companies and certain nonbank financial institutions from proprietary trading and investments and sponsorships of hedge funds and private equity funds
- Federal Reserve will have rule-making authority (and will act upon recommendations of the Council) with respect to rules prohibiting proprietary trading and investments and sponsorships of hedge funds and private equity funds
- Large complex companies will be



The final shape of securitization reform is beginning to gel. In addition to the changes effected by the Dodd-Frank Act, the SEC recently released a 667-page proposed rule amending Regulation AB's registration, disclosure, and reporting requirements for asset-backed securities and other structured finance products. And the FDIC released a proposed rule amending its "securitization rule" safe harbor to require financial institutions to retain more of the credit risk from securitizations and reflect recent accounting changes. This was preceded by the FASB's revisions to accounting rules relating to sales of financial assets and consolidation of certain off-balance sheet entities, revisions to bank capital rules to reflect FASB's accounting changes and the enactment of the Hiring Incentives to Restore Employment Act, which imposes a 30% withholding tax on foreign financial institutions, including certain offshore securitization vehicles.

# The major elements of securitization reform are:

## Credit Risk Retention

- 5% to be retained by the securitizer; however, if originator retains some amount of risk, only the remaining risk (up to 5% total) will be allocated to securitizer
- Risk retention also to apply to CDOs, securities collateralized by CDOs and similar instruments
- Risk retention types, forms and amounts for commercial mortgages to be determined by regulators, including permitting a third party that purchases a first-loss position at issuance and who holds adequate financial resources to back losses substituting for the risk retention requirement of the securitizer
- Percentage retained can be lowered based on underwriting standards used
- An exemption for qualified residential mortgages
- Other exemptions will be available at regulators' discretion
- No hedging or transfer of risk
- Creation of different asset classes, which may be subject to different regulations

## Required Disclosures

- Asset-level or data-level detail, including data with unique identifiers relating to

loan brokers or originators, the nature and extent of the compensation of the broker or originator of the assets backing the security, and the amount of risk retention of the originator or securitizer of such assets

- Fulfilled and unfulfilled repurchase requests across all trusts will be aggregated by the originator, so investors may identify originators with clear underwriting deficiencies
- Due diligence analysis must be performed by securitizer and provided to investors

## Representations and Warranties

- Credit rating agencies must explain, in reports accompanying credit ratings, representations, warranties, and enforcement mechanisms available to investors and how they differ from representations, warranties and enforcement mechanisms in similar issuances

## Other

- Regulations relating to credit risk retention requirements will become effective one year from enactment for residential mortgage assets, and will become effective two years from enactment for all other asset classes



Title VII of the Dodd-Frank Act, to be known as the Wall Street Transparency and Accountability Act of 2010, will impose a comprehensive and far-reaching regulatory regime on derivatives and market participants. Major elements of Title VII are summarized below.<sup>1</sup> However, many sections of Title VII require various studies to be undertaken and mandate or permit significant rulemaking by the Commodity Futures Trading Commission (“CFTC”), the Securities and Exchange Commission (“SEC”), and various Federal banking regulators. As a result, a full assessment of the impact of Title VII will only be possible once that rulemaking advances.

<sup>1</sup> Unless otherwise specified, for convenience we refer to swaps and security-based swaps as “swaps,” swap dealers and security-based swap dealers as “swap dealers,” and major swap participants and major security-based swap participants as “major swap participants” or “MSPs.” We also use the term “applicable regulator” to refer to the CFTC, in the case of swaps, and the SEC, in the case of security-based swaps. For a description of the Act’s prohibition on proprietary trading, please see our separate summary of the Volcker Rule.

### Lincoln Provision (the “Swaps Pushout” Rule)

- No “Federal assistance” (e.g., advances from any Federal Reserve credit facility or discount window that is not part of a broad-based eligibility program, FDIC insurance, or guarantees) may be provided to any “swaps entity” (i.e., swap dealers and non-bank major swap participants, or MSPs).
- The prohibition does not apply to insured depository institutions that limit their swap activities to (i) hedging and other similar risk mitigating activities directly related to their activities and (ii) engaging in swaps involving rates or reference assets that are permissible for investment by national banks. For purposes of the exception in clause (ii), CDS is permissible only if cleared.
- The prohibition only applies to swaps entered into after the end of the transition period, which could be up to five years after enactment.

### Regulatory Framework and Key Definitions

- The Act creates parallel regulatory regimes for the CFTC and SEC and divides jurisdiction between the two regulators based on whether a “swap” or a “security-based swap” is involved. The CFTC will have jurisdiction over “swaps” and certain swap market participants, and the SEC will have jurisdiction over “security-based swaps” and certain security-based swap market participants. Banking regulators will retain jurisdiction over certain aspects of banks’ derivatives activities (e.g., capital and margin requirements, prudential requirements).
- **Swap.** This term is broadly defined to include many types of derivatives across various asset classes, but excludes, among other things, nonfinancial or security forwards that are intended to

be physically settled, futures contracts, listed FX options, debt securities, securities options and forwards that are subject to the Securities Act of 1933 (“33 Act”) and the Securities Exchange Act of 1934 (“34 Act”), and security-based swaps. FX swaps and FX forwards qualify as swaps, unless the Secretary of the Treasury determines otherwise; however, notwithstanding any such determination, all FX swaps and FX forwards must be reported to a swap data repository or, in the absence of one, to the applicable regulator, and swap dealer and MSP counterparties to FX swaps and FX forwards must conform to business conduct standards applicable to swap dealers and MSPs.

- **Security-based Swap.** A “security-based swap” is a swap on a single security or loan or a narrow-based security index (generally, an index with 9 or fewer component securities). The definition also includes credit default swaps relating to a single issuer or the issuers in a narrow-based security index.
- The Act creates two new categories of significant market participants: swap dealers and major swap participants.
- **Swap Dealer.** A “swap dealer” is any person who holds itself out as a dealer in swaps, makes a market in swaps, regularly enters into swaps with counterparties as an ordinary course of business for its own account, or engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps. The term excludes persons that enter into swaps for their own account, either individually or in a fiduciary capacity, but not as a part of a regular business. It also does not include insured depository institutions that offer to enter into swaps with their customers in connection with originating loans with those customers.

The Act requires the CFTC and SEC to prescribe a *de minimis* exception to being designated as a swap dealer.

- **Major Swap Participant.** A “major swap participant” (“MSP”) is any person who is not a swap dealer and:
  - Maintains a “substantial position” (to be defined by the applicable regulators) in swaps for any major swap category, excluding positions held for hedging or mitigating commercial risk and positions maintained by any employee benefit plan for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan;
  - Whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or
  - Is a financial entity that is highly leveraged relative to the amount of capital that it holds, is not subject to any Federal banking agency’s capital requirements, and maintains a “substantial position” in outstanding swaps in any major swap category.
- Certain captive finance affiliates of manufacturers that use swaps to hedge commercial risks relating to interest rate and FX exposures are excluded from the definition of major swap participant.

## Clearing and Trading Requirements

- **Mandatory Clearing.** A swap must be cleared if the applicable regulator determines that it is required to be cleared and a clearing organization accepts the swap for clearing.
  - The determination process may be initiated by the applicable regulator or by a clearing organization, and may relate to any single swap or any group,

category, type, or class of swaps.

- Mandatory clearing requirement will not apply to existing swaps if they are reported to a swap data repository or, if none, to the applicable regulator in a timely manner.

- **Commercial End User Exception.**

The Act provides an exception to the mandatory clearing requirement if one of the counterparties to the swap (i) is not a financial entity, (ii) is using swaps to hedge or mitigate commercial risk, and (iii) notifies the applicable regulator how it generally meets its financial obligations associated with entering into non-cleared swaps. Application of the exception is at the sole discretion of the commercial end user.

- The term “financial entity” includes swap dealers, MSPs, commodity pools, private funds (as defined in the Investment Advisers Act of 1940), employee benefit plans, and persons predominantly engaged in activities that are in the business of banking or in activities that are financial in nature, but excludes certain captive finance affiliates. The Act directs the applicable regulators to consider whether to exempt small banks, savings associations, farm credit system institutions, and credit unions.

- **Mandatory Trade Execution.** To the extent that a swap must be cleared, it must be executed on an exchange or swap execution facility, unless no exchange or swap execution makes the swap available for trading.

- **Non-ECPs.** Persons who are not eligible contract participants (“ECPs”) must always enter into swaps via an exchange.
  - For swaps, the illegality applies to the non-ECP.
  - For security-based swaps, the illegality applies to any person effecting the transaction with or for the non-ECP.

## Regulation of Swap Dealers and Major Swap Participants

- **Registration.** Swap dealers and MSPs must register as such and will be subject to a regulatory regime that will be defined, to a very large extent, by rulemaking. Registration is required with an applicable regulator regardless of whether the entity is registered with the other applicable regulator or is a depository institution.
- **Capital and Margin.** The applicable regulators (for non-banks) and the Federal banking regulators (for banks) will set minimum capital requirements and initial and variation margin requirements for swap dealers and MSPs.
  - To offset the “greater risk” of non-cleared swaps, the capital and margin requirements must help ensure the safety and soundness of the swap dealers and MSPs and be appropriate for the risk associated with the non-cleared swaps held by those entities.
  - The Act permits the use of noncash collateral and, for non-cleared swaps, requires swap dealers and MSPs to hold their counterparties’ initial margin, upon request, in a segregated account at an independent third party custodian.
  - The Act does not provide an exemption to the margin requirements for commercial end users, although Senators Dodd and Lincoln stated in a June 30, 2010 letter to Chairmen Frank and Peterson their view that the Act does not authorize the regulators to impose margin requirements on commercial end users. Note, however, that imposing margin requirements on swap dealers and MSPs for non-cleared swaps could, in effect, be passed on to end users through swap pricing and/or margin requirements imposed by swap dealers and MSPs.

- **Business Conduct Standards.** Swap dealers and MSPs must conform with business conduct standards, including:
  - Disclosure to non-swap dealer and non-MSP counterparties of the material risks and characteristics of the swaps and any material incentives or conflicts of interest that the swap dealer or MSP may have in connection with the swaps; and
  - Additional responsibilities with respect to “special entities” (*i.e.*, States, municipalities, State and Federal agencies, pension plans, governmental plans, and endowments):
    - A swap dealer that acts as an advisor to a special entity has a duty to act “in the best interests of” the special entity; and
    - A swap dealer or an MSP that offers or enters into a swap with a special entity must comply “with any duty” established by the applicable regulator that requires the swap dealer or MSP “to have a reasonable basis to believe” that the special entity is advised by a qualified independent representative.

## Miscellaneous

- The Act increases eligibility requirements for ECPs
- The applicable regulators are authorized to establish aggregate position limits and large trader reporting requirements for swaps.
- Swaps shall not be considered to be insurance and may not be regulated as insurance contracts under State law.
- The SEC is authorized to expand the beneficial ownership rules in sections 13 and 16 of the 34 Act to security-based swaps.
- Offers and sales of security-based swaps to non-ECPs must be registered, notwithstanding sections 3 and 4 of the 33 Act.



The financial crisis took many investors by surprise. It became clear that investors in certain financial products, such as auction rate securities, did not understand how the secondary market for such securities functioned. Ponzi schemes were exposed at a rapid pace and clients lost faith in those with custody of their securities and/or funds. On December 30, 2009, the SEC adopted amended Rule 206(4) under the Investment Advisers Act to address certain custody issues. Congress also aims to increase investor protection as a means of bolstering investor confidence and bringing investors back to the capital markets.

### **Liability and Disclosures**

- Empowers the SEC to promulgate a fiduciary standard for broker-dealers that provide personalized investment services
- Mandates a study by the SEC on imposing a uniform fiduciary duty on financial intermediaries who provide similar advisory services
- Mandates a study on whether there are legal or regulatory gaps in standards in the protection of retail customers relating to the standards of care for various financial intermediaries
- Prohibits or limits use of mandatory arbitration
- SEC may require disclosures if a broker-dealer sells only proprietary products

### **Custody and Client Requests**

- SEC will review rule changes of self-regulatory organizations that affect custody of customer securities or funds
- Independent verification of client assets held in custody of adviser

### **Conflicts of Interest**

- SEC shall facilitate the provision of simple and clear investor disclosures regarding the terms of relationships with broker-dealers and investment advisers and disclosures of conflicts of interest
- Requires a study on conflicts of interest involving analysts

### **Point-of-Sale Disclosures**

- SEC may issue rules regarding required point-of-sale disclosures

### **Short Sales**

- Requires a study on short selling

### **SEC Powers**

- SEC may share information with federal, foreign and state regulators and law enforcement without waiving privilege
- SEC will be self-funded
- SEC may engage in consumer testing
- Oversight of private funds managed by investment advisers

### **Other**

- Awards to whistleblowers
- Creation of SEC Investor Advisory Committee to consult on initiatives to promote investor confidence
- Changes the accredited investor standard by excluding, in the calculation of net worth, the value of an investor's primary residence
- Requires a study on appropriate criteria for determining accredited investor status and eligibility to invest in private funds
- Requires a study of the feasibility of a self-regulatory organization to oversee private funds
- Provides for special protection for senior investors



The Credit Rating Agency Reform Act passed in 2006 requires credit rating agencies (CRAs) to register with the SEC and submit reports. Recently proposed amendments to SEC rules attempt to address concerns raised regarding CRAs following the financial crisis, and the Dodd-Frank Act goes even further.

## Liability

- Eliminates the exemption provided by Rule 436(g) under the 33 Act from the consent filing requirement for registration statements and potentially subjects CRAs to liability under Section 11 of the 33 Act
- Duty to report violations of law to appropriate authorities
- Enforcement and penalty provisions of the 34 Act apply to CRA statements to same extent as to registered public accounting firms or securities analysts
- Modification to “state of mind” requirement for private securities fraud actions against CRAs for money damages

## Required Disclosures

- Qualitative and quantitative methodologies and assumptions used
- Historical rating performance data required over multiple years, including for ratings that were withdrawn
- SEC to issue rules requiring CRAs to disclose information on initial ratings and subsequent changes; disclosures to be comparable across CRAs
- SEC must require each CRA to accompany publication of each rating with a prescribed form that details, among other things, ratings methodologies

## Prohibited Activities

- SEC to promulgate rules separating rating activities from sales and marketing activities
- SEC may impose fines, including fines for failure to supervise
- Each CRA must establish, maintain, enforce, and document an effective internal control structure
- CRAs must submit an annual report to the SEC, including a CRA internal controls report along with a CEO attestation

## Governance

- At least half of the CRA board of directors must comprised of independent directors (no fewer than 2), with a portion of the directors to include users of ratings
- Independence is based on the presence no consulting, advisory or compensatory fee or status as an associated person of the CRA, and on not being disqualified from any deliberation involving a particular rating
- Independent directors to serve for a fixed, non-renewable term not to exceed 5 years, with compensation not linked to the business performance of the CRA
- The board of directors has specifically mandated oversight responsibilities

with respect to policies and procedures for determining ratings, conflicts of interest, internal controls and hiring and promotion

### **Conflict of Interest**

- Compliance officers cannot participate in determining ratings or methodologies, or in sales activities or setting of compensation levels for certain employees
- Compliance office compensation must not be linked to financial performance of a CRA and must be arranged to ensure independence of the compliance officer
- Compliance report required to be filed annually with the SEC
- A one-year look-back requirement is imposed on any involvement of specified persons in the ratings process, as well as required reporting of employment transitions for specified CRA personnel
- Procedures required for the receipt, retention and treatment of complaints
- SEC to promulgate additional regulations to prevent sales and marketing from influencing ratings; SEC may suspend or revoke a CRA's registration for violations

### **Oversight**

- Establishes SEC Office of Credit Ratings; director of Office reports to SEC Chairman
- Establishes fines, penalties for CRAs; administers SEC rules applicable to CRAs

- SEC will conduct annual exam of each CRA; SEC to report on CRA exams

### **Other**

- Due diligence reports prepared by third parties for asset-backed securities must be disclosed and certified
- SEC will issue rules regarding requisite training, experience and competence for CRA analysts
- SEC will issue rules regarding ratings procedures and methodologies
- SEC rules will require that CRAs establish, maintain and enforce policies and procedures that define and disclose the meaning of any ratings symbol
- Statutory references to ratings are removed from federal statutes, and federal agencies will review reliance on references to ratings
- SEC will conduct a study regarding independence of CRAs
- Additional studies will be required to be conducted, including studies regarding alternative business models, the creation of an independent professional analyst organization, and the ratings process for structured finance products



The Volcker Rule provisions, named for former Federal Reserve Chairman Paul Volcker, are premised on the belief that speculative trading activities contributed in part to the financial crisis. The original House bill did not contain Volcker Rule provisions, although it did contain certain limitations on permitted activities (for example, the House bill permitted a ban on proprietary trading that poses systemic risk). In January 2010, the Obama Administration endorsed the Volcker Rule. The Senate bill imposed a prohibition on most proprietary trading by U.S. banks and their affiliates, subject to limited exceptions, and restricted covered institutions from owning, sponsoring or investing in hedge funds or private equity funds. Discussions relating to the Volcker Rule were among the most heated.

# The following summarizes the key Volcker Rule provisions contained in the Dodd-Frank Act (Title VI):

## **Prohibition on Proprietary Trading**

There are important distinctions made between the activities that may be conducted by banking entities and those that may be conducted by nonbank financial companies supervised by the Federal Reserve.

- Except for certain permitted activities, a “banking entity” cannot (1) engage in proprietary trading, or (2) acquire or retain any equity, partnership or other ownership interest in or sponsor a hedge fund or private equity fund (collectively “fund activities”).
- A “nonbank financial company” that engages in proprietary trading or fund activities will be subject to additional capital requirements and quantitative limits, to be established by rule. However, if a nonbank financial company engages in any permitted activities (i.e., any of the activities that a banking entity is permitted to engage in), the capital requirements or quantitative limits applied to the nonbank financial company for those activities will be the same as those applied to banking entities engaging in such permitted activities.

Proprietary trading is defined as engaging as principal for the trading account of the banking entity or nonbank financial company in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, any derivative, any contract of sale of a commodity for future delivery, any option on any such security, derivative, or contract, or any other security or financial instrument that the appropriate federal agencies may determine.

“Banking entities” are bank holding companies (BHCs), non-U.S. entities treated as BHCs, insured depository institutions,

and affiliates or subsidiaries of the foregoing.

“Nonbank financial companies” are certain U.S. or foreign companies that, though not BHCs or insured depository institutions, predominately engage in financial activities (as defined in the Bank Holding Company Act) and which will become subject to the supervision of the Federal Reserve based on a determination by the Council.

## **De Minimis Investment**

A banking entity may make and retain an investment in a fund that the banking entity organizes and offers; provided, that, it seeks unaffiliated investors for the fund; within one year of a fund’s start date, the banking entity’s investments shall not exceed more than 3% of the total ownership interests in such fund; and the aggregate of investments in all such funds does not exceed 3% of the banking entity’s Tier 1 capital.

## **Permitted Activities**

The following activities are “permitted activities”:

- transactions in U.S. government securities (including securities of the GSEs);
- transactions in connection with underwriting or market-making activities, to the extent designed not to “exceed the reasonably expected near term demands of clients, customers or counterparties”;
- risk-mitigating hedging activities in connection with a banking entity’s individual or aggregate positions, contracts or holdings that are designed to reduce the banking entity’s specific risks in connection with such positions, contracts or holdings;
- customer transactions;
- SBIC investments;

- the purchase or sale of securities and derivatives by a regulated insurance company engaged in the insurance business, subject to state insurance regulation and federal safety and soundness review;
- organizing and offering a private equity or hedge fund, if the banking entity:
  - provides bona fide trust, fiduciary, or investment advisory services;
    - provides trust or related services and offers interests in the fund only in connection with providing such services only to bank customers;
    - does not acquire or retain an equity interest, partnership interest, or other ownership interest in the funds except for de minimis investments (see above);
    - observes the restrictions on affiliate transactions;
    - does not, directly or indirectly, guarantee or assume, or otherwise insure, the obligations or performance of the fund;
    - does not share a name or derivation of a name or other marketing with the fund;
    - does not permit any director or employee of the banking entity to take or retain an equity interest, partnership or other ownership interest in the fund, except for any director or employee who is directly engaged in providing investment advisory services to the fund; and
    - discloses to prospective and actual fund investors that losses sustained by the fund are not borne by the banking entity;
- certain proprietary trading that occurs solely outside of the U.S. by a banking entity that is not directly or indirectly controlled by a banking entity organized under the laws of the U.S.;
- the acquisition or retention of an ownership interest or the sponsorship of a fund by a banking entity solely outside of the U.S. if interests in the fund are not offered or sold to a U.S. resident and the banking entity is not directly or indirectly controlled by a banking entity organized in the U.S.; and
- all other activities deemed appropriate by the applicable oversight agencies that would promote the safety and soundness of the banking entity.

No activity may be deemed a permitted activity if it would (1) result in a material conflict of interest for the banking entity; (2) result in a material exposure for the banking entity to high-risk assets or high-risk trading strategies; or (3) pose a threat to the safety and soundness of the banking entity.

### **Permitted Services**

A banking entity or a nonbank financial company may provide prime brokerage services to a sponsored fund if the provision of such services complies with other applicable restrictions of the regulations and the CEO (or equivalent officer) of the banking entity certifies annually to such compliance. Prime brokerage transactions will be subject to Section 23B.

### **Capital Requirements**

Oversight agencies will adopt additional capital requirements and quantitative limits.

### **Restrictions on Affiliate Transactions**

A banking entity that serves as an investment adviser or sponsor to a fund or that organizes and offers interests in a fund may not enter into “covered transactions” (as defined under Section 23A of the Federal Reserve Act) with the fund and that banking entity also shall be subject to the restrictions of Section 23B of the Federal Reserve Act in respect of transactions with the fund.

### **Required Study**

Within six months of enactment, the Council will conduct a study and make recommendations regarding implementation of these measures. Within nine months of completion of the study, the appropriate agencies will consider the findings and adopt rules to implement these measures.

### **Phase-In Period**

Generally, these provisions shall take effect on the earlier of: 12 months after the date of the issuance of the final rules, or two years after the date of enactment of the Dodd-Frank Act.

Bank entities and nonbank financial companies will have two years after the effective date (or two years after the date on which the entity becomes subject to Federal Reserve supervision as a bank entity or a nonbank financial company) to bring their activities into compliance. This phase-in period may be extended by the Federal Reserve for one year at a time, with extensions not to exceed an aggregate of three years. However, the Federal Reserve may extend the period in order to permit compliance with a contractual obligation that was in effect on May 1, 2010.

### **Conflict of Interest Provisions (Merkley Provisions)**

An underwriter, placement agent, initial purchaser, sponsor (or any affiliate) of an asset-backed security (as defined under Section 3 of the 34 Act, but, for

these purposes, including synthetic asset-backed securities) shall not engage in any transaction that would involve or result in any material conflict of interest with respect to any investor in a transaction arising out of such affiliate. This prohibition will apply for a one-year period that begins on the offering date.

Within 270 days of enactment of the Dodd-Frank Act, the SEC shall promulgate rules to implement this prohibition.

The prohibition shall be subject to exceptions for the following:

- Risk-mitigating hedging activities in connection with underwriting or offering the asset-backed security; provided such activities are designed to reduce specific risk to the financial intermediary associated with positions arising in connection with the asset-backed security offering; and
- Purchases or sales of asset-backed securities made pursuant to and consistent with commitments by the financial intermediary to provide liquidity for the asset-backed security.



Lingering concerns with executive compensation and corporate governance practices at public companies (including companies outside of the financial services industry) culminated in specific provisions of the Dodd-Frank Act that require new stock exchange listing standards, mandated resolutions for public company proxy statements, and expanded disclosures for all public companies soliciting proxies or consents. As a result of these provisions, companies will potentially have to change the composition and operation of their compensation committees, adopt new governance and compensation policies, and prepare for an advisory vote on executive compensation.

### **Say-On-Pay**

- Companies must include a resolution in their proxy statements asking shareholders to approve, in a non-binding vote, the compensation of their named executive officers
- A separate resolution will be required to determine whether the Say-on-Pay vote takes place every one, two, or three years
- To the extent that any “golden parachute”-related compensation is not approved as part of a Say-on-Pay vote, a separate non-binding vote will be required to approve that compensation in the event of a merger or similar extraordinary transaction
- The proxy statement for a meeting involving a “Say-on-Golden Parachute” vote would need to include “clear and simple” disclosure of the golden parachute arrangements or understandings and the amounts payable

### **Compensation Committee and Adviser Independence**

- Stock exchanges must adopt listing standards providing that the members of the compensation committee meet enhanced independence standards comparable (but not identical) to what is required for audit committee members under the Sarbanes-Oxley Act
- New listing standards will prescribe that a compensation committee may only select compensation consultants, legal counsel, or other advisers after taking into consideration independence standards established by the SEC
- Enhanced disclosure is required regarding the use of compensation consultants and any conflicts of interest

### **Enhanced Compensation Disclosure**

- Disclosure is required of the relationship of the compensation actually paid to

executives versus the company’s financial performance

- Companies must disclose the median annual total compensation of all employees (except the CEO), the annual total compensation of the CEO, and the ratio of the median employee total compensation to the CEO total compensation
- Disclosure is required of whether any employee or director (or designee of such persons) is permitted to purchase financial instruments designed to hedge their equity securities

### **Clawbacks**

- Stock exchanges must adopt standards requiring that listed companies develop and implement policies providing for the recoupment of compensation in the event of an accounting restatement
- Enhanced disclosure will be required of a company’s policy on incentive-based compensation that is based on financial information required to be reported under the securities laws

### **Other Governance Provisions**

- The Act authorizes the SEC to promulgate rules allowing certain shareholders to include director nominees in the company’s proxy materials, but does not prescribe specific standards for those rules
- Disclosure is required of the reasons why the company has chosen to have one person serve as Chairman and CEO, or to have different individuals serve in those roles
- Brokers are not permitted to use discretionary authority to vote proxies in connection with election of directors, executive compensation, or other significant matters as determined by the SEC



Generally, the Dodd-Frank Act imposes more stringent regulatory capital requirements on financial institutions. The Act requires that the Council make recommendations to the Federal Reserve regarding the establishment of heightened prudential standards for risk-based capital, leverage, liquidity and contingent capital.

### Supervised Nonbanks and Bank Holding Companies with Total Consolidated Assets Equal to or Greater than \$50 Billion

- The Federal Reserve must establish prudential standards for these institutions, which include:
  - Risk-based capital requirements;
  - Leverage limits;
  - Liquidity requirements;
  - Requirements for a resolution plan; and
  - Concentration limits
- These standards also should include a contingent capital requirement, requirements for enhanced public disclosures, short-term debt limits, a risk committee requirement, a stress test requirement, and maximum leverage ratio
- These institutions will be subject to a maximum debt-to-equity ratio of 15-to-1

### Collins Amendment Provisions

- Require the establishment of minimum leverage and risk-based capital requirements
  - Set the risk-based capital requirements and the Tier 1 to total assets standard applicable to insured depository institutions under the prompt corrective action provisions of the Federal Deposit Insurance Act
  - Set these current rates as a floor
  - Limit regulatory discretion in establishing Basel III requirements
- Raise the specter of additional capital requirements for activities that are determined to be risky, including, but not limited to, derivatives, securitized products, financial guarantees, securities borrowing and lending and repos
- All of these requirements become effective upon the adoption of implementing

regulations, which are required to be passed within 18 months of the Act's enactment

### **Effect on Hybrids**

- The application of the prompt corrective action provisions for insured depository institutions to bank holding companies no longer permits the inclusion of trust preferred securities or other hybrid securities in the numerator of Tier 1, subject to certain exceptions and phase-in periods as discussed below
  - Mutual holding companies and thrift and bank holding companies with less than \$15 billion in total consolidated assets are not subject to this prohibition
  - Intermediate U.S. holding companies of foreign banks have a five-year phase-in period
  - For newly issued securities (those issued after May 19, 2010), the requirement is retroactively effective
  - For bank holding companies and systemically important nonbank financial companies, hybrids issued prior to May 19, 2010 will be subject to a phase in from January 2013 to January 2016

### **Required Studies**

- There are a number of studies required that impact regulatory capital requirements
  - Hybrids: Within 18 months of enactment, the GAO must conduct a study on the use of hybrid capital instruments and make recommendations for legislative or regulatory actions regarding hybrids
  - Contingent capital: within two years of enactment, the Council must present the results of a study on contingent capital that evaluates, among other things, the effect on safety and soundness of a contingent capital requirement, the characteristics and amounts of contingent capital that should be required and the standards for triggering such requirements; following this study, the Council may recommend to the Federal Reserve certain minimum contingent capital requirements



In short

There will be much more to come once the studies mandated by the Dodd-Frank Act are completed.

There also is every reason to believe that the rule-making process will be a long and winding road. We will provide regular updates on our dedicated regulatory reform webpage

<http://www.mofo.com/resources/regulatory-reform/>.



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