PART 1:

DODD-FRANK SUMMARY

www.stlouisfed.org/rrr/

http://reformtracker.aba.com/
TITLE I – FINANCIAL STABILITY

“Never Again”

SUBTITLE A – Financial Stability Oversight Council

- Creates “FSOC” to:
  - Identify risks
  - Foresee potential systemic problems
- Requires identification of systemically significant nonbanks “predominately (85%) engaged in financial activities” (“SSNFCs”)
- Requires supervision and regulation of SSNFCs by Fed
  - Carves out non-financial activities
- Recommendations to Fed for “heightened” prudential standards for >$50B BHCs and SSNFCs
- “Hotel California” ->$50B BHCs that took TARP may not escape regime by de-banking
TITLE I – FINANCIAL STABILITY

“Never Again”

SUBTITLE B – Office of Financial Research

- Data calls
- Enormous reach and subpoena power

SUBTITLE C – Additional Board of Governors Authority for Systemically Significant Nonbank Financial Companies and Large Bank Holding Companies

- >$50B BHCs and SSNFCs subject to Fed supervision, regulation, examination, and enforcement
TITLE I – FINANCIAL STABILITY -Continued

“Never Again”

- $50B BHCs and SSNFCs subject to extensive prudential and reporting standards
  - Risk-based capital requirements (which must include off-balance sheet risks)
  - 15:1 leverage limit, if entity is deemed to pose a grave threat
  - Liquidity requirements
  - Reports of credit exposures with other large BHCs or SSNFCs
  - Concentration limits (which includes a BHC lending limit and attribution rule)
  - Orderly resolution plans (i.e., living wills)

- $50B BHCs and SSNFCs must provide 60 days’ prior Fed notice for any acquisition of a nonbank company >$10B; subjects SSNFCs to BHCA Section 3
  - No exemption for well-capitalized well-managed BHCs
  - Limits SSNFC investment in banks
TITLE I – FINANCIAL STABILITY- Continued

- Risk management committee required if publicly reporting and >$10 billion (may be imposed on smaller reporting BHCs in the Fed’s discretion)

- Stress testing
  - For $50B BHCs and SSNFCs, annual Fed stress-testing and semi-annual self stress testing
  - For BHCs >$10 billion, annual self stress testing

- Leverage and risk-based capital floors (the “Collins Amendment”)
  - BHC capital on a consolidated basis must be the same as the bank requirement
  - Trust preferred restrictions and limits: BHCs >$15 billion

- Optional prudential requirements on $50B BHCs and SSNFCs:
  - Contingent capital
  - Enhanced disclosures
  - Short-term debt limits
  - Others?
**Title II – Orderly Liquidation**

“No More Too-Big-to-Fail?”

- Orderly liquidation authority ("OLA") for systemic risk entities
  - Requires determination of “systemic risk”
  - Applies to BHCs, SSNFCs, BDs, insurance companies
  - Like a bankruptcy with FDIC as receiver
    - Priority scheme, with perfected security interest honored
    - Creditors use claims procedure
    - Avoidance, repudiation, disallowance, and preference powers
    - Shareholders last to be paid
    - Management and board removed

- No taxpayer funds to be used. $50B banks will be assessed
- Any other bankruptcy proceeding is to be dismissed in favor of receivership
- No court has jurisdiction
Title III – Transfer of Powers

“Enhancing Safety and Soundness”

Subtitle A – Transfer of OTS Powers and Duties (7-21-11)

- Supervision and rulemaking authority shifted:
  - Federal Thrifts to OCC (charter survives);
  - Thrift holding companies to Fed (HOLA survives);
  - State Savings Banks and S&Ls to FDIC; and
  - Any other powers (especially consumer protection) to CFPB.

- OCC Reestablished: directives modified to include assuring safety & soundness of supervised entities, fair access, fair customer treatment.
  - OCC responsible for OTS legal actions and property.
TITLE III – TRANSFER OF POWERS, Continued

SUBTITLE B – Transitional Provisions Relating to Subtitle A

SUBTITLE C – Deposit Insurance Reform

- Deposit Insurance Assessments:
  - Institutions may be denied lowest risk category due to size.
  - FDIC assessment base now depends on assets, minus tangible equity, not deposits.
  - Procyclical Assessments: FDIC may suspend dividends from DIF.
  - FDIC must move towards new minimum in DIF: 1.35% of estimated deposits / assessment base (9-20-2020). Small banks are exempt.
- FDIC coverage permanently increased to $250,000.
- FDIC Board: OTS Director seat replaced with Director of CFPB.
SubTitle D – Other Matters

- Branching: a savings institution’s ability to branch is not inhibited by its becoming a bank.

- Office of Minority and Women Inclusion: established in each agency. Has authority to assess the diversity policies and practices of supervised entities.

- Insurance of transaction accounts continued: unlimited non-interest bearing transaction account coverage 1-1-11 through 12-31-2012 (essentially, extends TAG, except no right to opt-out and NOW accounts and certain sweeps not covered).
“Enhanced Regulation”

- SEC registration of advisers to hedge funds and private funds if assets at least $150 million.
  - New recordkeeping and disclosure requirements, even for advisors of funds with < $150 million.

Exemptions: venture capital funds*, family offices*, foreign private funds, commodity trading advisors, SBIC advisors.

*As defined by SEC.

Eliminated exemptions: intrastate clients, private advisor.

- Assets-under-management trigger for federal regulation of investment advisers raised from $25 million to $100 million. (SEC may raise.)
Title IV – Continued

- Recordkeeping Obligations for Private Funds (maintained, not filed)
  - Assets under management
  - Leveraged positions, including off-balance sheet leverage
  - Exposure to counterparties
  - Valuation policies and practices
  - Types of assets
  - Side letter and similar arrangements
  - Trading practices

- Records of private funds subject to periodic & special SEC exam
- Registered private fund advisers required to file SEC reports
- SEC able to require disclosure of client ID and information “for purposes of assessment of potential systemic risk”
Mid-sized private funds

SEC to prescribe regulations imposing registration requirements of the Investment Advisers Act to investment advisers of “mid-sized private funds”

SEC to consider whether size, governance and investment strategies pose systemic risks so registration/examination requirements are appropriate

Foreign private advisers exempt from registration

No U.S. place of business and less than 15 U.S. investors with less than $25 million in corresponding assets under management
Other provisions

- Application of Investment Advisers Act will not avoid rights and remedies under Commodity Exchange Act (for CFTC or private parties)

- Accredited investor threshold of $1.0MM adjusted for inflation – excludes primary residence and is subject to future adjustment (but not < $1.0MM)

- SEC to review for inflation the “qualified client” standards of $750K under management and $1.5 MM net worth for purposes of adviser-imposed performance-based fees

- SEC may issue rules requiring safeguarding of client assets in custody
TITLE V – INSURANCE

“Steps to Federalization of Insurance?”

SUBTITLE A – Office of National Insurance

- No optional federal charter (yet)
- Treasury will negotiate international insurance agreements

SUBTITLE B – State-Based Insurance Reform

- Surplus lines
- Reinsurance
TITLE VI – IMPROVEMENTS TO REGULATION OF BANKS, …

“De-Risking”

- “Soup to Nuts” basic bank reg changes
- Restrictions on Expansionary Activities
  - BHC must be well-capitalized and well-managed to be FHC
  - Must be well-capitalized for interstate branching and deals
  - Thrift acquisitions subject to deposit cap
  - No interstate deals over 10% of liabilities
  - Eliminates prior notice exemption for FHC acquisitions if target >$10B
  - Serious ramifications for thrifts that fail QTL test
  - Confirms that SLHC activities same as FHCs, with same limitations
  - Moratorium on CEBA bank acquisitions by “commercial firms”
**“De-Risking”**

- Related Party Transaction Reform
  - Swaps, repos, derivatives, securities lending/borrowing transactions, etc. subject to Reg O, lending limits and Sections 23A & B
  - Investment fund advised by a bank is a 23A and B affiliate
  - 23A collateral requirements must be met “at all times”
  - 23A exemptive authority transferred from Fed to primary federal regulator
  - Repos as extensions of credit (not asset purchases)
  - Netting regulations?

- Supervisory Jurisdiction
  - Limits charter shopping by troubled institutions
  - Fed may examine BHC and each subsidiary, with backup examination authority conferred on the OCC/FDIC
  - Codifies source of strength doctrine
“De-Risking”

- Volcker Rule
  - Restrictions on investing in or sponsoring private equity funds / hedge funds by a banking entity
  - Restrictions on proprietary trading by a banking entity
  - Bar on 23A-like restrictions transactions with a fund that is sponsored, managed, or advised by banking entity
  - No conflict of interest transaction for one year after securitization

- Other
  - Expands de novo interstate branching as if bank were a state bank in the state
  - Permits interest bearing commercial DDAs in July 2011
TITLE VII – WALL STREET TRANSPARENCY AND ACCOUNTABILITY

“Enhanced Regulation”

SUBTITLE A – Regulation of Over-the-Counter Swaps Markets

PART I – Regulatory Authority

➢ Swaps Push-Out Rule (the “Lincoln Amendment”)

PART II – Regulation of Swap Markets

SUBTITLE B – Regulation of Security-Based Swap Markets
“Enhanced Regulation”

Establishes new regulatory framework for systemically important “FMUs” & systemically important payment, clearing and settlement (“PCS”) activities conducted by FIs

- FMU = manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among FIs or between FIs and a person.

- PCS = transmittal and storage of payment instructions, netting transactions, movement of funds, final settlement of financial transactions, management of associated risks and activities, provision and maintenance of trade, contract, or instrument information, etc.

Coverage not limited to DIs, but may apply to broker/dealers, investment companies, insurance companies, commodity trading advisors, and others.
“Systemically Important” = failure or disruption to functioning of utility or conduct of PCS activities → increased risk of significant liquidity or credit problems among FIs or markets → threaten stability of financial system

Factors

- Aggregate monetary value of transactions processed by FMU or carried out through PCS activity
- Aggregate exposure of FMU or FI engaged in PCS activities to its counterparties
- Relationship, interdependencies, or other interactions of FMU or PCS activity with other FMUs or PCS activities
- Effect that the failure or a disruption to the FMU or PCS activity would have on critical markets, FIs or broader financial system
- “Any other factors” FSOC deems “appropriate”
TITLE VIII – Continued

- Consequences of systemic importance
  - Heightened risk management standards (to be promulgated by Fed)
    - Risk management policies and procedures
    - Margin & collateral requirements
    - Participant or counterparty default policies & procedures
    - Ability to complete timely clearing and settlement
    - Capital & financial resource requirements for FMUs
    - Other areas
  - Heightened reporting, examination, enforcement provisions for FMUs and FIs engaged in systemically important PCS activities
  - FMUs must provide 60 days notice of proposed material changes to rules, procedures, operations
  - FMUs given access to discount window
  - FMUs subject to annual examination
Practical Concerns

- Regulatory Burden → Costs → fees and services (both FMUs & FIs)
- Increase cost & complexity & longer response time for FMU rule, system, and operational changes
- Additional complexity for new product offerings (both FMUs & FIs)
- FMUs & FIs may need to build processes to collect, collate and report data
- Specific examination power given over FMU’s third-party service providers if services provided are “integral to operation of” FMU
- Are low value, retail payments systems (ACH, Image, others?) systemically important?
TITLE IX – INVESTOR PROTECTIONS AND IMPROVEMENTS TO REGULATION OF SECURITIES

SUBTITLE A – Increasing Investor Protection
SUBTITLE B – Increasing Regulatory Enforcement and Remedies
SUBTITLE C – Improvements to the Regulation of Credit Rating Agencies
SUBTITLE D – Improvements to the Asset-Backed Securitization Process
SUBTITLE E – Accountability and Executive Compensation
SUBTITLE F – Improvements to the Management of the Securities and Exchange Commission
SUBTITLE G – Strengthening Corporate Governance
SUBTITLE H – Municipal Securities
SUBTITLE I – Public Company Accounting Oversight Board, Portfolio Margining, and Other Matters
SUBTITLE J – Securities and Exchange Commission Match Funding
Title IX – Continued

- Title IX establishes broad initiatives to improve:
  - Investor protection
  - Securities disclosures and enforcement
  - Broker-dealer and investment adviser regulation
  - Credit rating agency regulation
  - Credit retention requirements
  - SEC management and funding
  - Executive compensation practices and disclosures
  - Corporate governance matters
  - Oversight of municipal securities and advisors
Standard of Conduct:

- SEC required to issue a study on a standard of conduct for broker-dealers and investment advisers (issued 1/21/11)
- SEC should exercise its rulemaking authority to implement a uniform fiduciary standard

Duty of Loyalty

- SEC should prohibit certain conflicts and facilitate clear, uniform disclosures for retail customers about relationships with their broker-dealers and investment advisers, including material conflicts of interest

Duty of Care

- SEC should specify uniform standards, through rulemaking and/or interpretive guidance, for the duty of care owed to retail investors and include minimum baseline professionalism standards
TITLE IX – Continued – Securities Enforcement/Disclosure

➢ General:
  ➢ Enforcement scope expanded with greater tools for and reduced barriers to SEC enforcement
  ➢ Enhanced private remedies
  ➢ SEC internal structural changes

➢ Capital Markets:
  ➢ SEC required to issue rules prohibiting Reg D offerings involving a Bad Actor:
    ➢ convicted of felony or misdemeanor in connection with purchase or sale of any security or in connection with false SEC filing, or
    ➢ barred from association with regulated entities of from engaging in the business of securities, or activities of insurance, banking, savings association or credit union, on account of fraud, manipulation or deception
Aiding and Abetting authority

- Expands mental state element for SEC aiding and abetting actions to include recklessness in addition to knowledge
- But no private right of action (GAO to study)

Whistleblower changes

- Compensation of whistleblowers who provide original information with between 10-30% of sanctions if > $1.0 million
- Funding of Investor Protection Fund up to $300 million to fund
- Private right of action against employers for retaliation
- Extends SOX statute of limitations from 90 to 180 days
- Expands SOX whistleblower provisions to all consolidated affiliates
- Industry concerns regarding undermining SOX hotlines in place
TITLE IX – Continued – Credit Rating Agencies

- General
  - Responds to concerns and criticisms in areas of internal controls, transparency, accountability and conflicts of interest of nationally recognized statistical rating organizations (NRSROs)

- Independent Boards
  - Each NRSRO must have board of directors with at least two independent directors comprising at least half of board to oversee policies and procedures

- Compliance Officer limitations
  - May not participate in credit ratings, modeling, or marketing/sales

- Increased liabilities and penalties (expert liability in offerings)
  - Elimination of Securities Act Rule 436(g) exemption of credit ratings from being considered part of registration statements

- Removal of references in statutes and regulations
  - Removal of references or reliance on credit ratings in regulations with alternative standards in one year; two years for certain statutory references
Title IX – Continued – Credit Retention Requirements

- General
  - Will require securitizers to retain credit risk in connection with asset-backed securitizations

- Risk retention requirement
  - SEC and federal banking agencies to jointly prescribe regulations requiring retention default of 5% of credit risk, unless high underwriting standards are met
  - FSOC issued study on effects of risk retention requirements of 941 on 1/18/11, with guiding principles for consideration in crafting requirements
  - Timeframe: credit risk retention rules to be adopted by April 19, effective one year from publication for residential mortgage-backed securities and two years for other classes
  - Carve-out of “qualified residential mortgages” to be defined jointly by federal banking agencies, SEC, HUD and FHFA
Major executive compensation and corporate governance provisions include:

- Say on Pay, Say When on Pay, and Say on Golden Parachutes;
- Broker discretionary voting
- Pay-for-Performance
- Internal Pay Ratio Disclosures
- Mandatory “Clawback” Policies
- Hedging Policies
- Compensation Committee Independence
- Compensation Consultant Independence

See supplemental slides 48-70
“Enhanced Regulation”

**SUBTITLE A** – Bureau of Consumer Financial Protection

**SUBTITLE B** – General Powers of the Bureau

**SUBTITLE C** – Specific Bureau Authorities

**SUBTITLE D** – Preservation of State Law

**SUBTITLE E** – Enforcement Powers

**SUBTITLE F** – Transfer of Functions and Personnel

**SUBTITLE G** – Regulatory Improvements

**SUBTITLE H** – Conforming Amendments

**TITLE X – BUREAU OF CONSUMER FINANCIAL PROTECTION**
“CFPB” or “BCFP” or “the Bureau”

Super agency to take over consumer affairs

“Independent” within Federal Reserve

All authority to prescribe rules or issue orders or guidelines (the so called “consumer financial protection functions”) transferred from the Fed, OCC, OTS, FDIC, FTC (with some limits), the NCUA, and HUD

Transfer date is July 21, 2011

Will examine banks with total assets over $10 billion

Unfair, deceptive and “abusive” trade practices

Authority to restrict mandatory pre-dispute arbitration requirements

Will establish a unit to collect, track and route consumer complaints
**TITLE X – Continued**

- Take Over Enumerated Consumer Laws
  - Alternative Mortgage Transactions Parity Act
  - Truth in Lending
  - Truth in Savings
  - SAFE Mortgage Licensing Act
  - RESPA
  - EFTA
  - ECOA
  - Fair Credit Billing Act
  - Home Owners Protection Act
  - Fair Debt Collection Practices Act
  - Gramm-Leach Privacy
  - HMDA
  - Home Ownership and Equity Protection Act
  - Consumer Leasing Act
Title X – Continued

- Not:
  - CRA
  - AML-BSA
  - Insider transactions - Regulation O
  - Affiliate transactions - 23 A and B
  - Flood insurance

- Bureau must “publish a single, integrated disclosure for mortgage loan transactions” which address requirements of RESPA and Truth in Lending
  - Proposed rule and model form required one year after transfer date

- Interchange regulation required by Fed within 9 months (“Durbin amendment”)
  - Must be “reasonable and proportional” to cost
  - < $10 billion exempt, but competitive impact
  - Authority transferred to CFPB on transfer date
Preemption rollback as of transfer date:

- Gone for operating subsidiaries of federal charters
  - *Watters* decision is overruled
  - Operations may be rolled up into the bank

- Field preemption disappears for federal thrifts

- *Barnett* standard is imposed with respect to state consumer financial laws
  - Discrimination
  - “Prevent” or “significantly interfere”
  - Interest rate export saved
  - Deference to OCC eliminated

- *Cuomo* decision is codified
  - State attorney generals have enhanced rights to enforce laws
“Give with one Hand; Take-Away with the Other”

- Fed may only do emergency lending in the future for liquidity purposes
  - Not to save a failing bank
  - Prohibited from lending to insolvent institutions
- GAO to review and audit credit facilities
- Transparency and release of information
TITLE XIII – PAY IT BACK ACT
“Save Taxpayers”

➢ TARP wind down
  ➢ TARP authority reduced to $475 billion (i.e., funds already authorized).
  ➢ TARP repayments (and Treasury’s EESA authority) may not be used to fund new programs after 6-25-10.

➢ Reduction of public debt
  ➢ GSEs / FHLBank: amounts received by Treasury (from obligations / securities sales, fees, assessments) must be used for debt reduction.
  ➢ Treasury required to report to Congress regarding TARP proceeds.

➢ Recovery Act Funds – must be returned to pay down the public debt:
  ➢ Funds sunset: any funds not obligated by 12-31-2012.
  ➢ Funds not accepted by the governor or legislature of a state.
TITLE XIV – MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT

“Never Again”

SUBTITLE A – Residential Mortgage Loan Origination Standards
SUBTITLE B – Minimum Standards for Mortgages
SUBTITLE C – High-Cost Mortgages
SUBTITLE D – Office of Housing Counseling
SUBTITLE E – Mortgage Servicing
SUBTITLE F – Appraisal Activities
SUBTITLE G – Mortgage Resolution and Modification
“Mortgage originators” subject to a “duty of care” standard to be qualified, registered and licensed, as required

Compensation based on terms of loan is prohibited, other than amount of principal (4-01-11)

If loan originator receives compensation directly from a consumer, they may not receive compensation from any other person

Prohibits steering of consumers to inappropriate or less advantageous mortgage products

Mortgage originators personally liable for violations of laws

TILA modified to prohibit making of a “residential mortgage loan” unless creditor “makes a reasonable and good-faith determination…that consumer has a reasonable ability to repay….”
TITLE XIV – Continued

- Qualified mortgage” presumed to comply with repayment ability requirements:
  - Does not allow negative amortization or interest deferral
  - No balloon payment (unless provided for by regulation)
  - Income and assets are verified and documented
  - For fixed rate loans, underwriting is based on fully amortizing payment and accounts for taxes and insurance
  - For ARM loans, underwriting is based on maximum rate during first five years & accounts for taxes and insurance
  - Complies with any guidelines or regulations on debt-to-income ratios or similar standards
  - Total points and fees do not exceed 3% of total loan amount
  - Term of loan does not exceed 30 years
TITLE XIV – Continued

- TILA modified to require written appraisals on residential mortgage loans secured by a principal dwelling that are not “qualified mortgage loans” and whose APRs exceed the following:
  - Loans of $417,000 or less: 1.5 percentage points over APOR
  - Loans over $417,000: 2.5 percentage points over APOR
  - Subordinate lien loans: 3.5 percentage points over APOR

- Requires two appraisals if
  - Loan is to finance acquisition from person who acquired less than 180 days earlier and property was acquired by that person for less than current sale price
  - Cost of second appraisal may not be charged to applicant

- Requires periodic statement on residential mortgages
  - For fixed rate mortgages, coupon book may be provided instead

- Requires notification to borrowers six months prior to initial interest rate adjustment on ARM loans

- Modifies TILA to require a notification to consumers if an escrow account is not established or is closed by consumer
What provisions will most impact my practice?

...My clients?
Supplemental Slides
(Excerpt from Basel September 12, 2010 Press Release)

Annex 2: Phase-in arrangements (shading indicates transition periods)
(all dates are as of 1 January)

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<td>Leverage Ratio</td>
<td>Supervisory monitoring</td>
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<td>Minimum Common Equity Capital Ratio</td>
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<td>Capital Conservation Buffer</td>
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<td>Minimum common equity plus capital conservation buffer</td>
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<td>Phase-in of deductions from CET1 (including amounts exceeding the limit for DTAs, MSRs and financials)</td>
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<td>20%</td>
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<td>Minimum Tier 1 Capital</td>
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<td>Minimum Total Capital</td>
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<tr>
<td>Minimum Total Capital plus conservation buffer</td>
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<td>9.25%</td>
<td>9.875%</td>
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<td>Capital instruments that no longer qualify as non-core Tier 1 capital or Tier 2 capital</td>
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<td>Phased out over 10 year horizon beginning 2013</td>
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| Liquidity coverage ratio | Observation period begins | | | | | | | Introduce minimum standard |
| Net stable funding ratio | Observation period begins | | | | | | | Introduce minimum standard |
TITLE VIII – Supplemental Slide

- Recent & Anticipated Developments
  - FSOC NPR on criteria, processes and procedures for designating FMUs (released March 17 – 60 day comment period)
  - FSOC has not yet addressed criteria and analytical framework for PCS activities carried out by FIs
  - CPSS-IOSCO Report *Principles for Financial Market Infrastructures*
    - If adopted, would replace previously published *Core Principles for SIPS, Recommendations for Securities Settlement Systems* and *Recommendations for Central Counterparties* (2001)
  - Anticipated Future NPRs (2\textsuperscript{nd} – 3\textsuperscript{rd} Quarter 2011)
    - Proposed rules on risk-management standards for FMUs
    - Requirements for notice of proposed material changes to rules, procedures, or operations
Standard of Conduct:

SEC required to issue a study on a standard of conduct for broker-dealers and investment advisers

- reviewing the effectiveness of existing legal or regulatory standards of care for providing personalized investment advice and recommendations about securities to retail customers, and
- assessing gaps, shortcomings or overlaps in standard of conduct and supervision of broker-dealers and providers of personalized investment advice to retail customers

SEC discretionary authority to adopt new fiduciary duty rule

SEC issued “913 study” on January 21, 2011
Core conclusions:

- SEC should exercise its rulemaking authority to implement a uniform fiduciary standard of conduct.
- Uniform rule will require all brokers, dealers and investment advisers, when providing personalized investment advice about securities to retail customers, to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer or investment adviser providing the advice.

Commissioner Elisse Walter’s view of new uniform standard:

- “Establishing a uniform fiduciary standard is central to protecting retail investors given that the lines between investment advisers and broker-dealers continues to blur, with both sets of professionals providing investment advice to my Aunt Millie and the rest of the retail investing public.” PLI Investment Management Institute – Keynote Address (2/10/11)
- Duty of Loyalty: SEC should prohibit certain conflicts and facilitate clear, uniform disclosures for retail customers about relationships with their broker-dealers and investment advisers, including material conflicts of interest.
- Duty of Care: SEC should specify uniform standards, through rulemaking and/or interpretive guidance, for the duty of care owed to retail investors and include minimum baseline professionalism standards.
Investment Adviser Examination Study:

Related “Investment Adviser Examination Study” required by Section 914, regarding the need to enhance examination of investment advisers

SEC required to examine:

- Frequency of investment adviser examinations over the past five years
- Whether designation of one or more investment adviser SROs would improve the frequency of examinations
- Current and potential approaches to examination of advisers who are also registered as or affiliated with broker-dealers

SEC recommended three alternatives to augment examinations of investment advisers:

- Impose user fees on investment advisers to fund examinations
- Utilize one or more SROs to oversee and examine investment advisers
- Authorize FINRA to examine dual registrant broker-dealer/investment advisers under the Advisers Act
Additional Study elements:

- **Principal Trading**: SEC guidance or rulemaking to show how broker-dealers can comply with the new uniform rule when engaging in principal trading.

- **Personalized Investment Advice About Securities**: SEC guidance or rulemaking to explain what is “personalized investment advice about securities.”

- **Investor Education**: SEC consider investor education outreach to complement to the uniform fiduciary standard.

- **Harmonizing rules**: SEC harmonization of rules in advertising and other communications, use of finders and solicitors, supervision, licensing and registration of firms, licensing and continuing education of associated persons, and books and records requirements.

Dissenting views by Commrs. Casey and Paredes:

- Joint Statement opposing Study as not recognizing that recommendations could adversely impact investors.
General:
- Enforcement scope expanded with greater tools for and reduced barriers to SEC enforcement
- Enhanced private remedies
- SEC internal structural changes

Capital Markets:
- SEC required to issue rules prohibiting Reg D offerings involving a Bad Actor:
  - convicted of felony or misdemeanor in connection with purchase or sale of any security or in connection with false SEC filing, or
  - barred from association with regulated entities of from engaging in the business of securities, or activities of insurance, banking, savings association or credit union, on account of fraud, manipulation or deception
Securities Investor Protection Act Reforms

- Expands customer funds protected under SIPC from $100K to $250K

Civil penalties in C&D proceedings provided to SEC

Expanded foreign information and jurisdiction

- Foreign public accounting firms must produce audit work to SEC and PCAOB if a registered public accounting firm relies on its audit work
- Antifraud provisions of securities laws extended to transactions outside the U.S. involving only foreign investors if
  - U.S. conduct “constitutes significant steps in furtherance of the violation” or
  - Conduct outside U.S. “has a foreseeable substantial effect within the U.S.”
TITLE IX – Supplement – Credit Rating Agencies

- General
  - Responds to concerns and criticisms in areas of internal controls, transparency, accountability and conflicts of interest of nationally recognized statistical rating organizations (NRSROs)

- Independent Boards
  - Each NRSRO must have board of directors with at least two independent directors comprising at least half of board to oversee policies and procedures

- Compliance Officer limitations
  - May not participate in credit ratings, modeling, or marketing/sales

- Increased liabilities and penalties (expert liability in offerings)
  - Elimination of Securities Act Rule 436(g) exemption of credit ratings from being considered part of registration statements
  - NSRSO consents, treatment as experts and accompanying liability
TITLE IX – Supplement – Credit Rating Agencies

- Private Right of Action
  - Exchange Act enforcement and penalty provisions apply to statements of credit rating agencies like registered public accountants and securities analysts
  - Statements not protected as forward-looking (not 21E safe harbor)
  - State of mind for private securities fraud actions modified to knowing or reckless failure to conduct reasonable investigation of rated security

- Conflicts of Interest
  - New firewalls between sales and ratings areas of NRSROs, with suspension or revocation penalties for violations
  - One-year look-back policy for employees of rated entities participating in determination of rating of such entity
  - Report to SEC any transition of personnel from NRSRO to rated entity (5 year employment history with NRSRO and prior 12 months rating)
  - Prohibition on advisory services in addition to ratings services
TITLE IX – Supplement – Credit Rating Agencies

- No FD exemption
  - NRSROs no longer exempt from Red FD disclosure rules

- Office of Credit Ratings
  - To be established by SEC, with oversight of NRSRO practices and fines and penalties authority

- Removal of references in statutes and regulations
  - Removal of references or reliance on credit ratings in regulations with alternative standards in one year; two years for certain statutory references

- Further Studies
  - SEC to study and report to Congress on credit ratings process for structured finance products, conflicts of interest in issuer/subscriber pay models, accuracy of ratings and alternative compensation
  - Study of independence of NRSROs
  - Study of standardizing credit ratings terminology
General will require securitizers to retain credit risk in connection with asset-backed securitizations

Risk retention requirement

- SEC and federal banking agencies to jointly prescribe regulations requiring retention default of 5% of credit risk, unless high underwriting standards are met
- Financial Stability Oversight Council (FSOC) issued study on effects of risk retention requirements of 941 on 1/18/11, with guiding principles for consideration in crafting requirements
- Timeframe: credit risk retention rules to be adopted by April 19, effective one year from publication for residential mortgage-backed securities and two years for other classes
- Carve-out of “qualified residential mortgages” to be defined jointly by federal banking agencies, SEC, HUD and FHFA
Say on Pay

- Nonbinding shareholder advisory vote on the compensation of named executive officers ("NEOs") at least once every three years from 2011
- Assessment of compensation of NEOs as set forth in Compensation Discussion & Analysis, compensation tables and other disclosures required by Item 402 of Regulation S-K
- Proxy materials must include a brief description of the effect of the Say on Pay vote (including non-binding nature)
- CD&A must address whether results of any previous say on pay votes (e.g., TARP or otherwise) were considered in determining compensation policies and decisions and how that consideration affected those policies and decisions

SEC recommended form of resolution or other custom

Broker discretionary voting not permitted for Say on Pay (or Say When on Pay votes)
Say When on Pay

- Nonbinding advisory shareholder vote to determine frequency of Say on Pay vote
- Must be conducted in 2011 and at least once every six years thereafter
- Board may recommend annual, biennial or triennial frequency, but proxy card must give shareholders opportunity to vote on any of four options (one, two or three years, or abstain)
- ISS uniform preference is for annual Say on Pay vote, absent significant company specific reasons otherwise, with mix of Company/Board recommendations
- Results of vote and determination of frequency is required to be disclosed in 10-Q for period in which vote is held (or 10-K if vote occurs during fourth fiscal quarter)
- Companies that adopt plurality shareholder recommendation for frequency of vote may exclude shareholder proposals relating to say on pay
Say on Golden Parachutes

- Any proxy statement seeking shareholder approval of a merger, acquisition, consolidation or sale of all or substantially all assets must provide a “clear and simple” disclosure of all agreements or understandings with any NEO of either the target or acquiring company concerning compensation that is based on or otherwise relates to the transaction (any “golden parachute”), and permit shareholders to conduct a non-binding “Say on Golden Parachute” vote.

Disclosures

- Must be presented in tabular and narrative formats.
- Required only with respect to payments based on or related to the transaction.
- Need not address previously vested equity awards, compensation already disclosed in Pension Benefits and Nonqualified Deferred Compensation Tables, or compensation from bona fide post-transaction employment agreements.
- Must address golden parachutes of both target and acquiring company.
- Narrative must describe duration, material conditions or obligations on receipt of payment including non-competition, non-solicitation, or confidentiality covenants, and provisions regarding waiver or breach; also must include specific circumstances triggering payment, form of payment, duration and identity of payor.
- Tabular separately identifies each element of golden parachute, provides aggregate total, and differentiates single and double trigger arrangements.
Say on Golden Parachute vote not required if golden parachute arrangements previously subject to a Say on Pay Vote

- Requires that shareholders have been provided with both tabular and narrative disclosures.
- New/modified golden parachutes require separate vote.
- Requires inclusion of second table in proxy or information statement.
- May not be useful exception:
  - ISS announced that Say on Pay proposals that include a Say on Golden Parachute proposal will be evaluated in accordance with usual guidelines “which may give greater weight to that component of the overall evaluation”
  - Companies with disfavored elements of golden parachutes (e.g., 3x multipliers, tax gross ups) may prefer to wait until transaction to make disclosure and seek shareholder approval, rather than risk ISS disapproval of entire compensation package
  - Risk minimized since both: (a) vote is non-binding; (b) disapproval does not affect merger; and (c) shareholders may be more favorable to consummation of transaction
Tabular Disclosure:

<table>
<thead>
<tr>
<th>Name</th>
<th>Cash</th>
<th>Equity</th>
<th>Pension/NQDC</th>
<th>Perquisites/Benefits</th>
<th>Tax Reimbursements</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
</table>

**Cash** – Cash severance payments (e.g., base salary, bonus and pro-rata non-equity incentive plan)

**Equity** – The dollar value of accelerated stock awards, in-the-money stock option awards for which vesting would be accelerated, and payments in cancellation of stock and option awards

   Equity would be valued based on the closing stock price per share as of the latest practicable date

**Pension/NQDC** – Pension and nonqualified deferred compensation benefit enhancements

**Perquisites/Benefits** – Perquisites and other personal benefits and health and welfare benefits

**Tax Reimbursements** – Includes 280G tax gross-up payments

**Other** – Any additional elements of compensation not specifically includable in the other columns of the table

**Total** – Aggregate total of all compensation
Elimination of Discretionary Broker Voting

National securities exchanges must prohibit brokers from voting uninstructed shares in:

- Director elections,

- Executive compensation matters, including, the Say on Pay, Say When on Pay, and Say on Golden Parachute votes, and

- Any other matters the SEC deems “significant” (expected to be proposed by the SEC between April and July 2011)
Pay for Performance disclosure

- Disclose information that shows the relationship between executive compensation actually paid to NEOs and the financial performance of the company
- Can be a graphic or narrative depiction of the relationship
- 2012 proxy season – SEC expected to propose rules between April and July 2011
- May be useful indicator of executive pay, depending on how SEC defines “pay”
  - Amounts shown on Summary Compensation Table are not “pay” (i.e., performance awards disclosed at “target” level, option valuation does not reflect actual gain)
  - Multi-year disclosure of compensation actually received over look-back period (e.g., 5 years) is best measure of performance
Internal Pay Ratio disclosure

- Disclose:
  - Median annual “total compensation” of all employees of the company other than the CEO,
  - Annual total compensation of the CEO, and
  - Ratio of these amounts

- “Total compensation” has the same meaning as it has for purposes of the Summary Compensation Table

- 2012 proxy season – SEC expects to propose rules between April and July 2011

- Pay Ratio flawed; fails to account for
  - organizational size
  - value of benefits of lower-paid employees
  - risks of equity-based compensation
Mandatory Clawback Policies

National securities exchanges must adopt rules prohibiting listing of any securities of an issuer that does not adopt a compensation recovery, or “clawback” policy

Will require companies to develop and implement a policy about recovering erroneously awarded compensation

Clawback policy applies:

- When a company is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirements under the securities laws
- To all current and former executive officers who received incentive-based compensation during the 3-year period preceding the restatement
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Unclear how “officer” will be defined (i.e., NEOs or all Section 16 officers).

“Excess compensation” subject to clawback:
- Defined as excess of amount of incentive compensation received over amount that should have been received;
- Includes stock option gain; and
- Unclear how stock option gain will be calculated.

Most companies will be required to revise existing clawback policies.
Joint Proposed Rules on Incentive Compensation of Financial Institutions issued 2/7/11

Apply to “covered financial institutions” >$1B in assets that maintain incentive-based compensation arrangements for certain “covered persons” (executive officers, employees, directors and principal shareholders)

- **Prohibit Payment of Excessive Compensation**: Covered financial institutions will be prohibited from maintaining incentive-based compensation arrangements that encourage covered persons to expose the institution to inappropriate risk by providing the covered person with “excessive” compensation;

- **Prohibit Excessive Risk-Taking Incentives**: Covered financial institutions will be prohibited from establishing or maintaining incentive-based compensation arrangements for covered persons that encourage inappropriate risks that could lead to a material financial loss;

- **Require Adoption of Appropriate Compensation Policies and Procedures**: Covered financial institutions will be required to maintain policies and procedures appropriate to their size, complexity and use of incentive-based compensation to help ensure compliance with the Joint Proposed Rules; and

- **Require Enhanced Regulatory Disclosure**: Covered financial institutions will be required to provide enhanced disclosure to regulators regarding their incentive-based compensation arrangements for covered persons within 90 days following the end of the fiscal year.
The Joint Proposed Rules supplement all other compensation-related guidance applicable to a covered financial institution, including the Interagency Guidance on Sound Incentive Compensation Policies finalized in June, 2010.

Covered financial institutions should be prepared to justify why their incentive-based compensation arrangements do not provide covered persons with excessive compensation or create excessive risk-taking incentives.

Covered financial institutions should be prepared to develop written policies and procedures describing the process for establishing, implementing, modifying and monitoring incentive-based compensation arrangements. These procedures should involve the active involvement of the board of directors (or a committee) and appropriate risk-personnel.

Covered financial institutions with assets of $50 billion or more will be required to defer at least 50 percent of the incentive-based compensation paid to executive officers for a period of at least three years. The amount deferred must be adjusted to reflect actual losses realized and performance measure that become known during the deferral period.

All financial institutions, including those with <$1B in assets, should be prepared for aspects of the Joint Proposed Rules to become “best practices” and be made applicable to them through regulators’ periodic examinations and other reviews.
Compensation Committee Independence

SEC to direct national securities exchanges to adopt rules regarding compensation committee independence for listed companies.

Factors to be considered in new rules:

- Sources of compensation paid to compensation committee members (e.g., consulting, advisory or other arrangements with the company), and
- Whether members are affiliated with the company, its affiliates or subsidiaries.

Compensation Committee must

- Have direct responsibility to retain, compensate and oversee compensation consultant, and
- Consider independence criteria in selecting compensation consultants, advisors and counsel.

Controlled company exemption

- Companies of which 50% or more of the voting power is held by an individual, group or another company.