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Financial Regulation Agreement

This Conference Summary deals with the conference report on HR 4173, Dodd-Frank Wall Street Reform and Consumer Protection Act, which the House is scheduled to consider Wednesday, June 30.

The agreement makes broad changes to the regulation of the nation's financial sector. It creates a council of federal regulators to monitor the financial system and a framework through which the FDIC could dissolve large failing financial institutions. The measure creates a Bureau of Consumer Financial Protection within the Fed to regulate consumer financial products. It also places limits on proprietary trading by banks; bars the Fed from providing emergency loans to individual institutions and requires Treasury Department approval for emergency aid; provides federal regulation of the over-the-counter derivatives market for the first time; and limits the fees charged to merchants for debit-card transactions.

The agreement filed Tuesday no longer includes a provision, approved by conferees last week, of $19 billion in fees that would have been collected over a four-year period from larger banks and hedge funds in order to offset the measure's costs. Conferees met again Tuesday night to strike the fee, and added language directing the FDIC to increase its reserve ratio and prohibiting new programs under TARP.

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Section I

Background & Summary

In the aftermath of the worst financial crisis since the Great Depression, and the deep recession that followed, Democratic lawmakers and the Obama administration vowed to press ahead with a broad overhaul of the nation's financial industry and the regulators that oversee it.

Causes of the Financial Crisis

Most experts agree the recent crisis was initially triggered by the failure of the subprime mortgage market and a resulting credit crisis. Causes of the financial crisis, however, go much deeper than simply the failing of the housing market.

Many experts point to the lax — or in some cases irresponsible — mortgage lending standards, which led people to purchase homes they could not afford, resulting in a housing bubble and then a severe housing crash that resulted in millions of people losing their homes or losing value in their homes, while Wall Street and investors lost hundreds of billions of dollars.

A significant catalyst cited for the deterioration of lending standards was the increasing use of securitization that drastically changed the nature and perception of risk. Instead of loan originators bearing responsibilities for loans (including bad ones), they were able to shift that risk to Wall Street firms, which then shifted the risk to investors. Often, the end product ended up being held by investors in collateralized debt obligation's (CDO's). CDO's are structured products that re-securitized many of the subprime loans that had already been securitized, essentially building another tower of risky subprime debt from the worst pieces of an existing tower of risky subprime debt. This practice increased the demand for bonds backed by subprime residential mortgages, thereby increasing the supply of subprime mortgages. Loans guaranteed by Fannie Mae and Freddie Mac also helped increase the supply of loans.

The explosion of CDO's containing re-securitized subprime mortgage bonds would not have been possible if it were not for the credit rating agencies that rated the bonds in the CDO's. In many cases, large institutional investors — such as pension funds — can only purchase investment grade securities. The credit rating agencies rated many of the CDO's that ended up failing as "AAA", or investment grade, and the subsequent developments raised questions about the agencies's ratings methodology, and led some to argue that there are significant conflicts of interest in the credit rating business.

The financial markets became extremely volatile once the inherent risk in these investments became clear and large financial firms starting experiencing substantial losses. A major reason for the significant amount of losses was the use of borrowed money — or leverage — to purchase investments, and the large losses being generated by derivative positions, principally credit default swaps (CDS), which were used as insurance against many of the CDO mortgage bonds. The total value of CDS positions and the firm responsible was largely unknown to firms and regulators. This increased concerns surrounding counterparty risk and the possibility of a domino effect if one large firm failed.

Many large firms did not have enough capital reserves on hand to cushion the potential losses that they would be realizing. The failure of Lehman Brothers and near failure of American International Group (AIG) proved these concerns to be valid and caused a panic and a run on non-bank financial institutions, including money market funds, which are often invested in commercial paper issued by corporations in need of short-term financing. The end result was a "credit crunch," where liquidity in the markets dried up and the ability for borrowers to access credit became extremely costly, if not impossible. Some have argued that the use of mark-to-market accounting — which is when assets are valued at their current market value instead of at historical cost — forced firms to sell assets (loans) at "fire-sale" prices, ultimately forcing prices even further down and creating a "pro-cyclical" environment by increasing the supply of various securities at a time when security values were falling.

Eventually, the government stepped in and provided financial assistance, although there was not a clear process establishing how to assist or liquidate a large distressed financial firm. The use of taxpayer money to keep many of the financial firms from going under left many to question the apparent lack of regulatory oversight and apparent gaps and inefficiencies existing in the regulatory apparatus. Some also point more broadly to the trend of deregulation starting decades earlier — including the repeal of the Glass-Steagall Act (PL 73-66) — which disallowed investment banks, depository banks and insurance companies from engaging in each others activities, as an important cause of the crisis. Many have also questioned the Federal Reserve's role in the crisis.

The public anger over taxpayer funds being used to assist financial firms was fueled further by the fact that many investors and managers of the failing firms received significant bonuses, leaving some to believe that inappropriate incentives existed, under which the "upside" of an individual's decision was rewarded, but the "downside" risk of that decision bore little consequence, leading to excessive risk taking.

Congressional & Administration Approaches

The Troubled Asset Relief Program established by a 2008 law (PL 110-343), created a Treasury Department program intended to purchase the "toxic" assets and stabilize the economy. With this backdrop and the increasing displeasure with how TARP

was administered, lawmakers and the public demanded that changes be made to the financial industry. After some of the largest institutions involved in the crisis got billions of dollars worth of taxpayer-funded support, the public and many lawmakers became infuriated by the perception that Wall Street was "back to business as usual", earning enormous profits and paying out large bonuses. This anger was further fueled by the stubbornly weak jobs market and the fragile state of the economy.

In response to the economic damage caused by the crisis and the strong public desire for congressional action, House Financial Services Chairman Barney Frank, D-Mass., and Senate Banking Chairman Christopher J. Dodd, D-Conn., each sponsored legislation to address the perceived causes of the crisis and broader problems in the financial industry. The House passed the Restoring American Financial Stability Act (HR 4173) in December 2009. The Senate followed suit, passing its version of the bill, in May 2010, which was based on an earlier Senate proposal.

Republicans have strongly supported the goals of reforming the financial industry, but many have expressed concerns over the direction that the congressional legislation has taken. They fear that many of the proposals being offered will adversely affect the financial industry, businesses and ultimately consumers. They argue that "excessive and unnecessary" regulation will increase cost to companies and make it harder and more expensive for businesses and consumers to access credit. Many Republicans proposed relying on the bankruptcy process, rather than a new government process to wind down — i.e., dismantle — failing institutions. There was also strong opposition against the initial bank assessment fee and other fees that would be generated by the measure. Many argued the the legislation would do little to improve the financial system and instead makes government "bailouts" more likely.

The Obama Administration has also strongly advocated the need for overhauling the financial system. Following the passage of the Patient Protection and Affordable Care Act (PL 111-148), the administration pushed financial regulation to the top of the legislative priority list. The Treasury Department drafted several legislative proposals, many of which have been incorporated into the final conference agreement. In their view, the current system is too focused on short-term gains at the expense of long-term growth and stability. They believe overhauling the regulatory regime of the financial system is long overdue and will reduce the excessive risk taking that led to the crisis and will instead promote long-term economic growth and stability.

The measure has drawn heavy criticism from the financial services industry, who argue the legislation could end up increasing the cost of and access to credit, for both businesses and consumers, hurting business and ultimately quashing any nascent economic recovery. Some Democrats have also voiced concerns, but for the opposite reason — that the package does not go far enough to regulate Wall Street and protect consumers.

Conference Negotiations

Conference negotiations between the House and Senate commenced on June 10, with Frank presiding over the panel. The conference includes 12 senators (seven Democrats and five Republicans) and 31 House members (20 Democrats and 11 Republicans).

The main priorities of both the House and Senate bills were largely similar, however, there were significant differences in several of the key areas that needed to be hashed out by conferees.

Some of the most contentious issues that had to be resolved during the conference included derivatives regulation; the existence of an orderly liquidation fund; where a new consumer protection regulator would be located; whether to limit interchange debit fees; and the so called Volcker Rule on bank proprietary trading.

Crafting derivatives language was one of the last major hurdles for conferees. Sen. Blanche Lincoln, D-Ark., included language in the Senate bill that forced commercial banks to "spin off" swaps operations completely or create a separate subsidiary for swaps operations. The financial services industry was adamantly opposed to this language and many lawmakers also had concerns that it went too far. Ultimately, an agreement was reached when House Agriculture Committee Chairman Collin C. Peterson, D-Minn., offered a new proposal that would require banks to wall off the riskiest derivatives from the part of the bank that holds deposits. But in a crucial departure from a plan offered by Lincoln, the House plan allowed banks to keep certain derivatives that pose less risk.

Reaching an agreement on the Volcker rule — which would ban banks from using their own money to buy or sell securities in financial markets to turn a profit — proved to be another major hurdle for conferees. The modified Volcker rule that negotiators accepted includes tighter language by reducing the discretion of regulators in implementing the Volcker rule, but loosening the ban on banks dealing with private equity firms or hedge funds.

Early in the morning of June 25, House voted 20 to 11 to approve the measure, and their Senate counterparts voted 7 to 5 for approval. The agreement gave the Obama administration a crucial victory and allowed the president to ramp up pressure on the other G-20 countries during a meeting in Toronto. Several Obama administration officials spent the final hours of the committee negotiations working with the negotiators in the committee room. Following the passage of the conference agreement from the committee, the president said, "the reforms making their way through Congress will hold Wall Street accountable so we can help prevent another financial crisis like the one that we are still recovering from."

Conferees had to reconvene on Tuesday, June 29, in order to resolve concerns over a proposed bank fee they had agreed to last week. The fee would have been issued over a four-year period, on financial institutions with more than $50 billion in assets and hedge funds with more than $10 billion in assets. The fee prompted several senators to indicate that they would not vote for the legislation on the Senate floor. Additionally, the death of Sen. Robert C. Byrd, D-W.Va., reduced the number of Democratic senators, complicating efforts to obtain the necessary 60 votes in the Senate. Conferees agreed to take out the fee on banks, and added new language intended to offset the measure's costs.

Summary of Conference Agreement

The conference agreement on HR 4173 makes broad changes to the country's financial regulatory framework by — expanding the government's powers to deal with failing financial companies and monitor systemic risk; creating a new Bureau of Consumer Financial Protection within the Federal Reserve (the Fed); restricting bank proprietary trading; bringing the multi-trillion dollar financial derivatives market under federal regulation for the first time; setting more stringent capital reserve standards for banks; providing a non-binding advisory vote to shareholders on executive compensation; and making many other changes to the current financial regulatory regime.

Derivatives

The measure provides regulation of the over-the-counter derivatives market for the first time, requiring many derivatives to be traded on exchanges and routed through clearinghouses. Derivatives transactions also would be subject to new capital, margin, reporting, and record keeping requirements.

The agreement allows for customized swaps to continue to be traded over-the-counter; however, they would have to be reported to central repositories, so regulators would understand the level and location of derivative exposure in the market and would be subject to margin requirements.

Under the agreement, banks would be required to spin off their riskiest derivatives trading operations into affiliates. This is a much softer requirement than what Sen. Blanche Lincoln, D-Ark., had proposed in the Senate bill, which would have required banks to spin off <u>all</u> of their derivatives operations, not only the most riskiest ones. Under the agreement, banks could retain operations for interest-rate swaps, foreign-exchange swaps, and gold and silver swaps among others. Swaps related to agriculture, uncleared commodities, most metals, and energy would be handled by bank affiliates.

'Volcker Rule' on Proprietary Trading

The agreement places new limits on propriety trading by the largest financial firms,

which is referred to as the Volcker Rule, after former Federal Reserve Chairman Paul Volcker, who advocated such a restriction. The version of the Volcker Rule in the agreement would not be as restrictive as the original Senate version, which would have completely banned banks from using their own money to buy or sell securities in financial markets to turn a profit. Some industry insiders believe the new limits would not affect many banks.

The agreement allows banks to invest up to 3% of their Tier 1 capital in private equity and hedge funds, but bars banks from owning more than a 3% ownership stake in any private equity group or hedge fund.

Orderly Liquidation Authority & Oversight Council

The measure provides federal regulators with new authority to break up large financial firms that are in distress by establishing a liquidation procedure run by the Federal Deposit Insurance Corporation (FDIC). The agreement does not contain a House-passed provision that would have established a fund to cover the cost of distressed firms. Under the measure, the Treasury Department would initially supply funds to cover the up-front costs of winding down the failed firm. The government would establish a repayment plan and recoup any losses incurred from liquidation afterward by assessing fees on financial firms with more than $50 billion in assets.

The agreement establishes a Financial Stability Oversight Council, consisting of federal regulators, that would be charged with monitoring and addressing systemwide risks to U.S. financial stability. The council would make recommendations to the Fed for items such as stricter capital and leverage requirements, and other rules for systemically important financial firms.

Consumer Financial Protection

The measure creates a new Bureau of Consumer Financial Protection that would be housed within the Fed. (A major point of contention among conferees had been on whether the new agency should be free standing, as proposed by the House, or housed within the Federal Reserve System, as proposed by the Senate.) The new agency would have rule-making and some enforcement power over banks and non-bank financial institutions that offer consumer financial products or services such as credit cards, mortgages and other loans.

Under the agreement, the new agency would have the authority to examine and enforce regulations for a variety of consumer finance oriented businesses, including mortgage related businesses; banks and credit unions with assets of more than $10 billion; pay-day lenders; and certain other non-bank financial firms. Auto dealers would, however, be exempt from the agency's oversight.

Bank Capital Standards

The agreement sets new risk-based capital standards for banks — including a prohibition on large bank holding companies treating trust-preferred securities as Tier 1 capital, which is considered to be a key measure of a bank's strength. These banks would have five years to phase out trust-preferred securities as Tier 1 capital.

The measure allows banks with less than $15 billion in assets to continue treating trust-preferred securities as Tier 1 capital.

FDIC & TARP Offsets

The agreement prevents the Treasury Department from making any more disbursements under TARP and also reduces the authorization for the program to $47.5 billion. It also requires the FDIC to charge large banks more money for deposit insurance, raising the reserve ratio from the current 1.15% to 1.35%. CBO estimates these actions would increase revenue by $13.5 billion over the period from FY 2010 to FY 2020 period. (Rep. Spencer Bachus, R-Ala., issued a statement Tuesday night calling the TARP change an "accounting gimmick," and the American Bankers Association have raised concerns about the FDIC changes that were agreed to on Tuesday.)

The agreement does <u>not</u> contain a provision that would have assessed a fee on large banks. The fee would have raised up to $19 billion and would have been based on the perceived level of risk inherent in the large financial institutions. Conferees met on June 29, and dropped the provision which had been agreed to during prior negotiations.

Federal Reserve Audit & Emergency Lending Restrictions

The measure allows for a one-time audit of all of the Fed's emergency lending programs from the financial crisis and requires the Fed to disclose, after two years, details of loans it makes to banks through its discount window as well as open market transactions. Under current law, the Fed is not subject to such oversight.

The agreement limits the Fed's "13(3)" emergency lending authority under "unusual and exigent circumstances" by forbidding the central bank from using it to aid an individual firm unilaterally. Instead, the Treasury would have to approve any lending program and prohibit the participation of insolvent firms. (The emergency lending authority played a prominent role during the recent crisis when the Fed was able to make emergency loans to American International Group (AIG) and other troubled firms.)

Interchange Debit Card Fees

The agreement, like the Senate bill, imposes limits on the debit-card transaction fees that banks charge merchants and retailers for using the system. conferees agreed,

however, to modify the provision to exempt certain types of transactions, including government assistance programs.

Executive Compensation

In an effort to curb executive compensation practices, the measure provides shareholders of public corporations a non-binding advisory vote on executive pay and "golden parachutes." The agreement also gives the Securities and Exchange Commission (SEC) the authority to grant shareholders proxy access to nominate directors.

Other Provisions

The measure also does the following:

- **Hedge Fund Registration** — Requires hedge funds and private equity funds to register with the SEC as investment advisers and provide information on trades.

- **Credit Rating Agencies** — Establishes stricter oversight of the credit-rating industry by creating an oversight office within the SEC with the ability to fine ratings agencies and empowering the SEC to de-register a firm that gives too many bad ratings over time. It also creates a new quasi-government entity designed to address conflicts of interest inherent in the credit-rating business.

- **Federal Insurance Office** — Creates a new Federal Insurance Office within the Treasury Department to monitor the insurance industry and make recommendations to the systemic risk council about insurers that should be treated as systemically important.

- **Office of Thrift Supervision** — Abolishes the Office of Thrift Supervision (OTS) and divides its supervisory responsibilities among other regulators including the Fed, FDIC and the Office of the Comptroller of Currency.

- **Securitization** — Requires banks to keep 5% of securitized assets on their balance sheets in order to

make them keep "skin in the game," and curb excessive risk taking.

CBO & JCT Cost Estimate

The Congressional Budget Office (CBO) and Joint Committee on Taxation (JCT) estimate that enacting the measure would increase revenues by $13.5 billion over the period from FY 2010 through FY 2020, and that it would increase direct (mandatory) spending by $10.2 billion over that same 10-year period. In total, CBO estimates that enacting the legislation would reduce budget deficits by a net $3.2 billion over the period from FY 2010 through FY 2020. Because enacting the legislation would affect direct spending and revenues, pay-as-you-go procedures apply.

As of press time Tuesday, CBO has not prepared a cost estimate for the changes in discretionary spending that would arise from implementing the conference agreement.

References

All Democratic conferees except Rep. Henry A. Waxman, D-Calif., signed the conference report (H Rept 111-366), which was filed June 29; no Republican conferees signed the report. The House passed the bill by a vote of 223 to 202 on Dec. 11, 2009 (see House Action Reports Fact Sheet No. 111-22, December 7, 2009 and House Action Reports Floor Summary No. 111-20, December 14, 2009). The Senate passed the bill by a vote of 59 to 39 on May 20, after inserting the provisions of its companion measure (S 3217).

Section II

Systemic Risk Reduction & Regulatory Changes

This section describes the provisions of the conference report on HR 4173, Dodd-Frank Wall Street Reform and Consumer Protection Act, that deal with systemic risk concerns and firms deemed "too big to fail." Specifically, this section addresses provisions including the establishment of a new oversight council and financial research office; the orderly liquidation of a failing financial institution; restriction on emergency lending by the Federal Reserve (the Fed) and new regulatory responsibilities of the Fed; the so called "Volcker rule" to limit proprietary trading by banks; the consolidation and reorganization of regulators; and the regulation of non-bank financial institutions. These provisions were principally drawn from the Senate version of the bill, which was passed by the Senate on May 20, and were later significantly modified during the conference committee negotiations.

Financial Stability Oversight Council

The measure establishes the Financial Stability Oversight Council (the council), which would be responsible for:

- Identifying risks to U.S. financial stability arising from from material financial distress or failure of a large, interconnected bank holding company or non-bank financial company.

- Promoting market discipline by eliminating the expectation among market participants that the government will shield them from potential losses in the event of an institutional failure.

- Responding to emerging threats to the U.S. financial system.

Membership

The council would be funded through the newly formed Office of Financial Research.

The council's voting member would include, the Treasury secretary, who would serve as chairman of the council; the chairman of the Federal Reserve Board; the comptroller of the Office of the Currency (OCC); the director of the Consumer Financial Protection Bureau (CFPB); the director of the Federal Housing Finance Agency; the chairman of the Securities and Exchange Commission (SEC); the chairman of the Federal

Deposit Insurance Corporation (FDIC); the chairman of the Commodity Futures Trading Commission (CFTC); the chairman of the National Credit Union Administration Board; and an independent insurance advisor appointed by the president. Several non-voting members also would serve on the council.

Duties

The measure requires the council to meet at least quarterly and to perform a series of duties, including:

- Collecting information from agencies, bank holding companies and non-bank financial companies in order to assess risks to the U.S. financial system;

- providing direction to, and requesting analysis from the Office of Financial Research;

- monitoring financial markets and identifying potential threats to the U.S. financial stability;

- monitoring domestic and international regulatory developments and proposals;

- facilitating information sharing between council member agencies and making recommendations to the agencies on supervisory priorities and principles;

- identifying potential regulatory gaps and requiring the Fed to supervise systemically important non-bank financial institutions;

- providing the Fed with recommendations on setting standards for risk-based capital, leverage, liquidity, contingent capital, resolution plans, credit exposure reports, concentration limits, enhanced public disclosures and overall risk management for non-bank financial companies and large bank holding companies;

- establishing standards for systemically important functions, including payment, clearing and settlement systems; and

- identifying emerging market developments, financial regulatory issues and jurisdictional disputes between council member agencies.

The council could request data from financial companies in order to assess whether or not a company, market or activity poses a threat to the U.S. financial system. Prior to this request, the council would have to first attempt to gather the needed information from the relevant agencies and regulators.

Non-Bank Financial Companies

The agreement specifies the council's authority over certain non-bank financial companies and large bank-holding companies. If the council determines that a non-bank financial company poses a threat to the U.S. financial system, then the council could vote to require the Fed to supervise and regulate the institution and require the company to register with the Fed. A two-thirds majority vote, with an affirmative vote from the chairman would be required.

In determining whether or not a non-bank financial company, including foreign firms, poses a systemic threat, the council would consider institutional factors, including — the degree of leverage; the amount and nature of financial assets held; the amount and types of liabilities held; the dependence on short-term funding; the extent and type of off-balance-sheet exposure; the extent of assets owned vs. managed; the extent of ownership interest in or operation of payment, clearing or settlement businesses; the extent of inter-connectivity and complexity of the institution; and other risk factors the council deems to be important. The degree to which the firm is an important source of credit for low-income, minority, or under-served communities also would be taken into consideration.

If the council determines that an institution poses a systemic threat to the U.S. financial system, then the institution could contest the decision and also request a judicial review of the councils decision.

The council could recommend that the Fed establish more stringent regulatory requirements for non-bank financial companies posing systemic threats, including — increased risk-based capital requirements; heightened leverage limits; increased liquidity requirements; and heightened contingent capital requirements. For the contingent capital requirement, the council would be required to provide Congress with a study on the feasibility, costs, benefits and structure of the contingent capital requirement within two years of enactment.

The council could recommend to the Fed that each non-bank financial company provide the council, the FDIC and the Fed with a satisfactory resolution plan in the event

that the company were in need of an orderly liquidation due to material financial distress or failure. The council may also recommend that the company report on the nature and extent of its credit exposure, including the amount of credit exposure that counterparties have in the non-bank financial company.

The measure indicates that bank-holding companies with at least $50 billion in total consolidated assets also could be subject to the more stringent regulatory requirements. Large non-bank financial companies that were recently classified as bank holding companies, and received financial assistance under the Troubled Asset Relief Program (TARP) also would be subject to this provision and Fed supervision.

Office of Financial Research

The agreement creates the Office of Financial Research within the Treasury Department which would be headed by a director, who would serve a six-year term and be appointed by the president and confirmed by the Senate.

The office would support the council and member agencies of the council. It would collect data and would conduct research on topics important to understanding potential risks posed to the U.S. financial system. The research data would be provided to the council's member agencies, commercial data providers, public data sources and financial entities.

The measure requires the office to provide Congress with a report, within two years of enactment and annually thereafter, on the financial stability of the U.S. financial system, the status of the office's mission and key findings from its research.

Under the agreement, funding for the office would be provided through assessments made by the Fed on non-bank financial companies and bank holding companies with total consolidated assets of at least $50 billion. This provision would not go into effect until two years after enactment, at which point the Treasury Department would create an assessment schedule, which would take relevant risk and systemic characteristics of the individual companies into consideration. The Fed would provide interim funding for the initial two year period.

Orderly Liquidation Authority

Funding for 'Winding Down'

The agreement establishes a liquidation procedure run by the FDIC for the purpose of winding down — i.e., dismantling — a large financial institution that is failing, as part of an effort to end the moral hazard know as "too big to fail."

The conferees note their expectation is that the orderly liquidation authority may be used in order to mitigate serious adverse effects on financial stability in the U.S. When the authority is used, the FDIC would be appointed receiver and would liquidate the company in a manner that mitigates significant risks to financial stability and minimizes moral hazard. Conferees note their expectation is that all costs of an orderly liquidation under the authority would be borne first by shareholders and unsecured creditors, and, if necessary, by risk-based assessments on large financial companies. Conferees argue that taxpayers specifically protected from losses associated with use of this authority.

The agreement does not contain a House-passed provision that would have established a fund to cover the cost of distressed firms. Under the measure, the Treasury would initially supply funds to cover the up-front costs of winding down the failed firm. The government would establish a repayment plan and recoup any losses incurred from liquidation afterwards by assessing fees on financial firms with more than $50 billion in assets.

Triggers & Process of Liquidation Authority

The measure's orderly liquidation authority is intended to be used in very rare circumstances and the assumption is that bankruptcy code will continue to be the primary path taken for liquidating a failing financial institution.

Under the agreement, if the Treasury secretary determines that a financial company is in distress then the secretary would notify the FDIC and the financial company. If the board of directors of the financial company acquiesces or consents to the appointment of the FDIC as receiver, the secretary would make the appointment. If the board of directors of the financial company does not acquiesce or consent, the secretary would petition the U.S. District Court for the District of Columbia for an order authorizing the secretary to appoint the FDIC as receiver. The court would determine if the financial company is in default or in danger of default, then the court would issue an order immediately authorizing the secretary to appoint the FDIC as receiver.

The Fed and FDIC also could request that the secretary place the FDIC as receiver if they deem the financial company to be in default or in serious danger of default. The judicial review process would still apply however. Under this scenario, the Fed and FDIC would provide the secretary with a written recommendation, that: 1) evaluates whether the financial company is in default or in danger of default, 2) describes the effect the failure of the institution would have on U.S. financial stability, 3) recommends steps that should be taken, 4) evaluates if there are any likely private-sector alternatives, 4) evaluates why bankruptcy is not appropriate, 5) evaluates the effect on creditors, shareholders and counterparties, and 6) describes the effect that the default would have on low-income, minority or under-served communities.

In addition to the above items, the secretary also would consider the cost to the Treasury Department and the potential that government intervention would increase excessive risk-taking by creditors, shareholders or counterparties due to the belief that the government would limit the downside risk associated with investing in or doing business with a failing institution.

In the event an orderly liquidation is triggered and the FDIC is made receiver, the measure assumes creditors and shareholders would take losses and the management team would be removed. In addition, management, board members and other individuals responsible for the failure would bear financial losses through clawbacks, restitution or other actions.

The measure stipulates that the FDIC would not take an equity interest in, or become a shareholder of, any financial company or any subsidiary.

The agreement stipulates that no taxpayer funds would be used to prevent the liquidation of any financial company under this measure. All funds would be recovered from the disposition of company assets or would be the responsibility of the financial sector through assessments. The agreement requires that taxpayers bear no losses from the exercise of any authority under this measure.

Legal Liability & Bankruptcy

Under the agreement, the institution's board of directors would not be held liable to shareholders or creditors for consenting to the appointment of a receivership. The FDIC could, however, hold directors and officers liable for monetary damages with respect to gross negligence.

The agreement expedites federal court consideration of cases brought by the FDIC against directors, officers, employees and agents of a covered financial company.

If an orderly liquidation is triggered, existing bankruptcy proceedings would be dismissed and new bankruptcy proceedings could not be filed.

The agreement requires unsecured claims of the United States to, at a minimum, have a higher priority than liabilities of the financial company that count as regulatory capital.

The measure provides guidance on the priority of unsecured claims during an orderly liquidation. All those who have a right to the claim would be treated in similar fashion, unless the FDIC determines not doing so would enhance the value of firm assets for sale.

The agreement authorizes the FDIC to repudiate and enforce existing contracts of the financial company during the orderly liquidation.

Broker-Dealers & Insurance Companies

The measure stipulates that insurance companies that are considered to be "covered financial companies" under the measure would be are subject to a liquidation governed by state law. If the state regulator fails to act, however, then the FDIC would have back-up authority.

The agreement stipulates that the FDIC, as receiver, would appoint the Securities Investor Protection Corporation (SIPC) as trustee to handle the orderly liquidation of a covered broker or dealer. The determination of claims and the liquidation of assets would be administered under the Securities Investor Protection Act (PL 91-598). Brokers or dealers who are not covered by SIPC would be subject to the applicable bankruptcy laws.

Additional Federal Reserve Authorities

The agreement provides the Fed with additional authorities and oversight powers.

Systemically important non-bank financial companies and bank holding companies would be required to provide the Fed with financial and operational reports, if required. As much as possible, the Fed would rely on reports and information already made available to other federal and state regulators.

The agreement provides that the Fed may recommend that the primary regulatory agency take enforcement actions if a non-bank financial company is not in regulatory compliance or poses a systemic threat. If the primary regulator does not take action, the Fed would maintain the right to take enforcement actions.

Unless prior notice is given, the measure prevents non-bank financial companies and large bank holding companies from acquiring or controlling companies that do not engage in banking activities and have at least $10 billion in total consolidated assets. The Fed would take the criteria outlined in the Bank Holding Act (PL 84-511) for acquisitions into consideration, as well as the level of risk that the acquisition poses to the U.S. financial system.

The measure allows the Fed to take early action if a non-bank financial company or bank holding company is in financial distress. The measure does not authorize any financial assistance from the federal government. Actions the Fed could take for a company in the early stages of financial distress would include setting limits on capital distributions, limiting acquisitions, and limiting asset growth. Actions the Fed could take for a company in the later stages of financial distress would include requiring capital

restoration plans, requiring capital-raising plans, setting limits on transactions with affiliates, requiring management changes, and requiring asset sales.

Resolution Plan Review

If the Fed and FDIC jointly determine that a company's resolution plan is not credible and would not facilitate an orderly liquidation under the bankruptcy code, then the company would have to submit a new plan. If the company does not re-submit a satisfactory plan, then the Fed, in consultation with the Financial Stability Oversight Council and the FDIC, could impose more stringent regulatory requirements or require the company to divest certain assets or operations.

Stress Tests

The Fed, in conjunction with other regulators, would conduct annual stress tests on bank holding companies and on non-bank financial companies over which it has supervision to evaluate whether the company has the capital, on a total consolidated basis, necessary to absorb losses as a result of adverse economic conditions.

Leverage Requirements

The agreement directs the Fed to require a bank holding company with total consolidated assets equal to or greater than $50 billion, or a non-bank financial company supervised by the Fed, to maintain a debt-to-equity ratio of no more than 15 to 1, if the council determines that the company poses a grave threat to U.S. financial stability and that the requirement is necessary to mitigate the risk.

Off-Balance Sheet Items

The agreement provides that, in the case of a bank holding company or non-bank financial company supervised by the Fed, the computation of capital for purposes of meeting capital requirements would take any off-balance sheet activities of the company into account.

The conferees note their expectation that this provision provides a specific, more stringent supervisory framework for regulating large, interconnected bank holding companies, non-bank financial companies that the council subjects to more stringent regulation, and activities and practices that the council determines could pose systemic threats.

Federal Reserve Emergency Lending & FDIC Guarantees

This measure amends Section 13(3) of the Federal Reserve Act (PL 63-43), which governs the Fed's emergency lending authority. Under current law, the Fed may lend to

any individual, partnership or corporation in "unusual and exigent circumstances," provided the borrower is unable to secure adequate credit accommodations from other banking institutions. This clause was rarely used by the Fed until the recent crisis, where it played a central role, allowing the the central bank to lend money to several firms, including American International Group (AIG).

The agreement bars the Fed from unilaterally providing emergency lending to an individual entity.

The agreement provides that the policies and procedures governing emergency lending would be established by regulation, in consultation with the Treasury secretary. The Treasury secretary would approve the establishment of any lending program, and lending programs would be designed to provide liquidity and not to aid a failing financial company. Under such programs, collateral or other security for loans would have to be sufficient to protect taxpayers from losses.

The measure requires the Fed to report to Congress within seven days anytime emergency lending is provided.

Conferees note their expectation that the Fed will be able to make 13(3) emergency loans only through widely available programs approved by the Treasury secretary, and not to individual firms.

FDIC Debt Guarantees

The measure permits the FDIC to guarantee the debt of solvent insured depositories and their holding companies under very strict conditions. The Fed and the Financial Stability Oversight Council would have to determine that there is a "liquidity event," that failure to take action would have serious adverse effects on financial stability, and that the guarantees are needed in order to avoid or mitigate the adverse effects.

The measure defines liquidity event as an exceptional and broad reduction in the general ability of financial market participants to sell financial assets without an unusual or significant discount, or to borrow using financial assets as collateral without an unusual and significant increase in capital. The term also would cover an unusual and significant reduction in the ability of participants to obtain unsecured credit.

The agreement requires the Treasury secretary to approve the terms and conditions of the guarantees. The secretary, in consultation with the president, would determine the maximum amount of guarantees, and the president could request Congress to allow that amount. Fees for the guarantees would be set to cover all expected costs. If losses occur, however, then they would be recouped from those firms that received the guarantees.

The measure prohibits the FDIC from using its systemic risk authority to establish a widely available debt guarantee program and requires the FDIC to become receiver of any insured depository institution that defaults on its debt guarantee. If the defaulting company is not an insured depository institution, then the FDIC would ultimately require the company to file for bankruptcy.

Conferees expect the FDIC programs to guarantee short-term debt during financial crises would be limited to solvent depository institutions and their holding companies, and can be created only after meeting several conditions including congressional approval.

Federal Reserve Governance

The agreement alters the manner in which Fed bank presidents are elected. Conferees expect the presidents of each Fed bank will be elected by the directors selected to represent the public (Class B and C directors), and that directors representing the member banks (Class A directors) will no longer be authorized to vote.

The measure provides the Fed with a formal responsibility to identify, measure, monitor and mitigate risks to U.S. financial stability, which does <u>not</u> exist under current law.

GAO Audits & Reports

The agreement requires the Fed to provide, within seven days of emergency loans being made, with information on any loan or other financial assistance given; the justification for issuing the loan; the identity of the loan recipients; the date, amount and form of the assistance; and the material terms of the assistance.

The agreement requires the Government Accountability Office (GAO) to conduct a one-time audit of the Fed's emergency lending that took place during the financial crisis, and to report on it by December 2010.

In a significant departure from current law, the agreement also permits the GAO to audit Fed credit facilities, typically emergency lending programs, and covered transactions, including open market transactions or discount window advances in the future. The release of the GAO report to Congress and the public would be be delayed in order to ensure that the information does not have adverse effects on the financial markets.

The audit would review the following information:

- The operational integrity, accounting, financial

reporting and internal controls governing the credit facility or covered transaction;

- the effectiveness of the security and collateral policies established for the facility or covered transaction in mitigating risk to the relevant Fed bank and taxpayers;

- whether the credit facility or covered transaction inappropriately favors one or more specific participants over other institutions eligible to utilize the facility;

- an assessment of the policies governing the use, selection or payment of third-party contractors by or for any credit facility or covered transaction.

The measure requires the Fed to publicly disclose emergency lending information, including — the names and identifying details of each borrower, participant, or counterparty; the amount borrowed by, or transferred by or to, a specific borrower, participant, or counterparty; the interest rate or discount paid by each borrower, participant or counterparty; and information identifying the types and amounts of collateral pledged or assets transferred in connection with participation. The disclosure would be made after the credit facility or covered transaction has been terminated.

The measure also requires the GAO to audit the FDIC debt guarantee program resulting from a liquidity event.

The conferees' expectation is that the GAO will conduct an audit of Fed 13(3) emergency lending since Dec. 1, 2007, and the Fed will publish details about such lending on Dec. 1, 2010. In addition, conferees expect the GAO will have ongoing audit authority over the Fed discount window and open market operation transactions, and the emergency lending authority. Conferees expect the Fed will publicly disclose data on discount window and open market operations, and details about emergency lending, after a delay that will allow these tools to function effectively.

Regulation of Holding Companies, Banks & Non-Bank Institutions

The agreement places a three year moratorium on the FDIC's ability to approve a new application for deposit insurance for an industrial loan company, credit card bank or trust bank that is owned by a commercial firm. Commercial firms are entities, including all affiliates, that derive at least 15% of their revenue from engaging in non-financial activities.

The measure, similar to a Treasury proposal, eliminates exceptions granted in the Bank Holding Company Act (PL 84-511), thereby disallowing a change in the control of a credit card bank, industrial loan company or trust bank, that would result in direct or indirect control by a commercial firm. There would be several exemption to this rule. The GAO would study the need for these exemptions and recommend whether they are appropriate.

Under the measure, bank holding companies would provide the Fed with information on all company activities, including subsidiary activity, in order to identify and address the risk throughout an entire organization. This measure removes the so-called Fed-lite provisions under the Gramm-Leach-Bliley Act (PL 106-102), which limited the Fed's ability to obtain information on bank-holding company subsidiary activity. The Fed would be required to use existing reports as much as possible in order to carry out these responsibilities.

The measure requires the Fed, other federal regulators and state regulators to coordinate regulatory activity as much as possible, in order to reduce the duplication of activities. The agreement requires similar coordination between bank holding company regulators and the primary regulator of a bank-holding company's subsidiary. Savings and loan holding companies also would be subject to these requirements.

When reviewing proposals by bank-holding companies and non-bank financial institutions for mergers and acquisitions, the Fed would have to consider the risks posed to the U.S. financial system due to the merger or acquisition. Financial holding companies would not require Fed approval for an acquisition unless the transaction results in the acquisition of assets exceeding $10 billion in value.

The agreement requires the Fed to examine the activities of non-depository subsidiaries of a depository holding company to determine the safety and soundness of the non-depository subsidiary's activities. The Fed would consult with state bank regulators when appropriate. If the Fed does not use its regulatory authority to provide examinations, then a different federal banking regulator would be granted back-up authority.

The measure amends the Federal Reserve Act (PL 63-43) by expanding the list of inter-affiliate "covered transactions" to include credit exposure from a securities borrowing, lending transaction or derivative transaction. This provision is an attempt to address risks that affiliates can pose to banks when they engage in risky derivatives transactions and incur significant losses. The measure provides some exemptions to this requirement.

The agreement provides the Fed with the power to set capital reserve levels for savings and loan holding companies and limits asset purchase or sale transactions with company insiders.

Lending Limits

The agreement tightens national bank lending limits —the percentage of bank capital that can be loaned to a single borrower — by treating credit exposure on derivatives, repurchase agreements and reverse repurchase agreements as extensions of credit for the purpose of lending limits. Lending limits, which prevent overexposure to any single borrower and the risk that the borrower will not repay the loan, are considered to be a key component of bank safety and soundness.

National banks would be required to take insider transactions and non-affiliate transactions into account when considering credit exposure.

State banks also would be subject to the lending limits required in this measure. State banks, however, would have a two year transition period to comply with these provisions.

Capital Levels

The agreement specifies that the Fed and other federal regulators will seek to make capital requirements for bank holding companies, savings and loan holding companies and insured depository institutions "countercyclical." The amount of capital required to be maintained by a company would increase in times of economic expansion and decrease in times of economic contraction, in order to be consistent with the safety and soundness of the company.

The measure allows banks with less than $15 billion in assets to continue treating trust-preferred securities as Tier 1 capital. This requirement would be phased in over an extended period.

The measure requires bank holding companies or savings and loan holding companies to serve as a source of financial strength for any subsidiary that is a depository institution.

'Volcker Rule' on Proprietary Trading

The agreement places new limits on propriety trading by the largest financial firms, referred to as the Volcker Rule after former Chairman Paul Volcker, who has advocated such a restriction. The version of the Volcker Rule in the agreement would not be as restrictive as the original Senate version, which would have completely banned banks from using their own money to buy or sell securities in financial markets to turn a profit.

This provision would take effect 12 months after the date of the issuance of final rules under the measure, or two years after the date of enactment of this provision.

Banking entities and non-bank financial companies supervised by the Fed would be required to bring their activities and investments into compliance with this provision two years after the date the requirements become effective, or two years after the date the company becomes a non-bank financial company supervised by the Fed.

Banks and non-bank financial companies could engage in trading activities for a variety of purposes including, but not limited to, risk-mitigating hedging activities and the purchase, sale, acquisition, or disposition of securities and other instruments on behalf of customers.

The agreement allows banks to invest up to 3% of their Tier 1 capital (generally the firm's common stock, retained earnings and trust-prefered stock) in private equity and hedge funds, but bars banks from owning more than a 3% ownership stake in any private equity group or hedge fund.

Concentration Limits on Large Financial Firms

The measure provides that financial companies could not merge or consolidate with another company if it would result in the new company having total consolidated liabilities exceeding 10% of the total amount of consolidated liabilities for all financial companies. The council's recommendation would be taken into consideration. The agreement requires the Financial Stability Oversight Council to conduct a study on the effect these limits would have on the financial system, from a regulatory and broader economic perspective.

Interstate Merger Transactions

The agreement prohibits regulators from approving an application for an interstate merger transaction if the resulting insured depository institution, bank holding company or saving and loan company — upon consummation of the transaction — would control more than 10% of the total amount of deposits of insured depository institutions in the United States.

Conferees

Conferees note their expectation is that these provision would improve the prudential regulation of banks, saving associations and their holding companies. The improvements would include significant limitations on proprietary trading and sponsoring or investing in hedge funds or private equity funds by banking entities through the Volcker rule; better supervision of non-bank subsidiaries of holding companies; enhanced restrictions on transactions with affiliates; limits on derivatives and securities lending credit exposure; and a requirement that any company that controls an insured depository institution serve as a source of financial strength to the institution.

Payment, Clearing & Settlement

The proper functioning of the financial markets is dependent on safe and efficient clearing, settlement and payment activities. This agreement provides the new Financial Stability Oversight Council with a role in identifying systemically important financial market utilities and enhances the Fed's role in supervising risk management standards for "systemically important" financial market utilities that manage or operate systemically important payment, clearing and settlement activities conducted by financial institutions.

'Systematically Important' Designation

Generally, financial market utilities would be deemed to be systemically important based on the aggregate monetary value of the transactions they process and the effect their failure would have on clearing, settlement and payment systems, as well as their effect on counterparties and the U.S. financial system. The designation would require a two-thirds affirmative vote of council members, including an affirmative vote by the chairperson of the council.

The measure requires the council to provide advance notice to financial institutions by publishing a notice in the Federal Register that designates the institution as being systemically important.

The agreement permits the financial market utility an opportunity for a written or oral hearing before the council to demonstrate that the proposed designation is not supported by substantial evidence.

Federal Reserve Standards

The agreement authorizes the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) to prescribe regulations, in consultation with the council and the Fed, containing risk management standards, taking into consideration relevant international standards and existing prudential requirements, for market utilities designated to be systemically important. The council and Fed could determine that the standards set by the CFTC and the SEC to be insufficient, in which case the council and Fed would prescribe risk management standards they determine necessary.

Under the agreement, the standards prescribed by regulators address — risk management policies and procedures; margin and collateral requirements; participant or counterparty default policies and procedures; the ability to complete timely clearing and settlement of financial transactions; capital and financial resource requirements for designated financial market utilities; and other areas that are necessary to achieve the objectives and principles of sufficiently overseeing systemically important market utilities.

The measure requires a firm engaging in these functions to gain prior approval from the Fed for any material changes to its rules, procedures or operations.

The measure authorizes the Fed to modify or provide an exemption to the reserve requirements to which these firms would otherwise be subject.

Examinations & Reporting

The agreement requires the relevant supervisory agency to conduct safety and soundness examinations of designated financial market utilities at least annually and authorizes the supervisory agency to take enforcement actions against the utility. The Fed also would be authorized to take enforcement actions against the firm if there is an imminent risk of substantial harm to financial institutions or the broader financial system.

Under the measure, the council would have the authority to collect information from financial market utilities and financial institutions engaging in payment, clearing or settlement (PCS) activities in order to assess systemic importance and could require these firms to submit reports on certain activity.

Conferees note that they expect a specific framework for promoting uniform risk-management standards for systemically important financial market utilities and systemically important PCS activities conducted by financial institutions would be created from this provision. The Fed, the SEC or CFTC would be primarily responsible for establishing and enforcing these standards. Conferees expect that if the Fed determines that the standards imposed by the SEC or the CFTC are insufficient, then the council can require the SEC or CFTC to impose additional standards or take additional enforcement actions.

Abolishment of OTS & Changes to Other Regulators

The measure abolishes the Office of Thrift Supervision (OTS) and re-distributes its powers and duties to the OCC, the Fed and the FDIC. The OTS is a bank regulator currently housed within the Treasury that oversees savings associations and holding companies, which primarily take deposits and lend them out for residential mortgages.

The agreement requires the transfer to take place 12 to 18 months after enactment of this measure.

New Supervisory Responsibilities

The agreement transfers to the Fed the supervisory responsibilities of savings and loan holding companies, including subsidiaries; state member banks; foreign banks specified under the Federal Reserve Act (PL 63-43); foreign banks not operating insured branches; agencies and commercial lending companies; and bank holding companies, including subsidiaries.

The agreement transfers to the Office of the Comptroller of the Currency the supervisory responsibilities for federal savings associations, national banking associations, and federal branches or agencies of foreign banks.

The agreement transfers to the FDIC the supervisory responsibilities of state savings associations, state non-member insured banks, and foreign banks having insured branches.

The measure requires OTS employees to be transferred to either the OCC, the Fed or the FDIC, depending on which agency is most suitable. It is expected, however, that most employees will be transferred to the OCC and the FDIC.

Conferees note their expectation is that the functions of the OTS that are transferred to the OCC are for federal thrifts; from the OTS to FDIC are for state-chartered thrifts; and from the OTS to the Fed are for thrift holding companies. Conferees also expect the measure would protect employees affected by the regulatory streamlining by preserving pay and benefits, and protecting them from involuntary separation or relocation for a period of time.

Fees

The measure allows the OCC to collect fees from any entity the OCC supervises in order to carry out the agency's responsibilities. In order to establish a fee schedule, the OCC would take into account the entity's activities; the amount and types of assets held by the entity; the financial and managerial status of the entity; and any other factors that the OCC deems appropriate.

The agreement allows the Fed to charge fees to large bank holding companies, large savings and loans companies, and non-bank financial companies that are supervised by the Fed. The fees would equal the expenses incurred for supervising these companies.

FDIC Changes

The measure directs the FDIC to change the manner in which the assessment base is calculated for insured depository institutions unless the FDIC can show that the new calculation would reduce the effectiveness of the risk-based assessment system or increase the risk of loss to the Deposit Insurance Fund. Custodial banks and banker's banks (banks that provide banking services to community banks) also could receive different treatment.

The new assessment base calculation would be equal to the average total assets of the institution during the assessment period minus the sum of: 1) the average tangible equity of the institution during the assessment period, and 2) the average long-term unsecured debt of the institution during the assessment period.

The agreement requires the reserve ratio designated by the board of directors for any year to be no less than 1.35% of estimated insured deposits, or the comparable percentage of the assessment base. This ratio was initially set to be 1.15% of estimated insured deposits, but was increased after conferees re-opended the conference on June 29 to remove a proposed assessment on banks. The agreement also directs the FDIC to take the steps that would be necessary for the reserve ratio to reach 1.35% of estimated insured deposits by Sept. 30, 2020. It also requires the FDIC when taking actions to increase the reserve ratio to offset those effects on the insured depository institutions with total consolidated assets of less than $10 billion.

The agreement makes permanent the increased maximum deposit insurance amount of $250,000; current law sets the maximum amount at $100,000, but the amount has been temporarily increased to $250,000 through Dec. 31, 2013. The measure makes the increase retroactive to Jan. 1, 2008.

Conferees note they expect the provision to revise the FDIC's assessment base for deposit insurance, maintaining the risk-based nature of the assessment structure but transitioning to a broader assessment base for bank premiums based on total assets (minus tangible equity). Conferees also note additional provisions would enhance the FDIC's ability to manage the Deposit Insurance Fund and make the increase in deposit insurance to $250,000 permanent. Full insurance of non-interest-bearing transaction accounts is also extended for an additional two years and a comparable program is authorized for credit unions.

Offices of Minority & Women Inclusion

The measure establishes an Office of Minority and Women Inclusion in several federal agencies, including the Treasury Department, the FDIC, the Fed, the OCC and others. The office would be responsible for ensuring that minorities and women are adequately represented at the various agencies and that the needs and views of the minority communities and women are adequately addressed by the agencies.

Section III

Consumer Financial Protection Bureau

This section deals with provisions of the conference report on HR 4173 that establish the Bureau of Consumer Financial Protection in the Federal Reserve (the Fed), and spell out the bureau's authority.

The agreement establishes the Bureau of Consumer Financial Protection (CFPB), which would be housed within the Federal Reserve (the Fed), instead of as a stand-alone agency as was proposed by the House. The CFPB would have the authority to regulate the offering and provision of consumer financial products and services. The CFPB would be headed by a director, appointed by the president and confirmed by the Senate for a five-year term; the director would be subject to removal for cause.

Conferees note their expectations are that the CFPB will have authority to issue rules applicable to all financial institutions that offer financial products and services to consumers and will also have authority to issue rules under existing consumer banking statutes. Conferees note that merchants, retailers, attorneys, accountants, real estate brokers, automobile dealers are exempt from CFPB oversight and allows for the pre-emption of state consumer financial laws that prevent or significantly interfere with national banks' exercise of their powers.

Governed Products

The CFPB would oversee a broad range of retail financial products, including checking accounts, private student loans, credit cards, mortgages and others. The agreement exempts auto dealers, as well as merchants, realtors, attorneys, accountants and real estate brokers from CFPB oversight. The CFPB would have the authority to deal with unfair, abusive and deceptive practices, which for example, could include the sudden doubling or tripling of the interest rates on credit cards.

Units

Under the agreement, the CFPB would contain functional units for research, community affairs, and consumer complaints in order to ensure that the CFPB has a robust knowledge of the markets for consumer financial products and services in order to meet its purposes and objectives in as efficient and effective manner as possible.

Responsibilities

The measure requires the CFPB to implement and enforce federal consumer financial laws to ensure that markets for consumer financial products and services are fair, transparent and competitive. The CFPB would ensure that consumers are provided with accurate, timely, and understandable information in order to make effective

decisions about financial transactions; that consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination; that unwarranted regulatory burdens are reduced; and that markets for consumer financial products and services operate transparently and efficiently in order to facilitate access and innovation.

The measure requires the CFPB to consider potential benefits and costs to consumers, and consult with prudential regulators regarding consistency with safety and soundness considerations and other objectives of such agencies when prescribing regulations. This consultation would take place prior to the CFPB proposing a rule, as well as during the public comment process. The CFPB would have the authority to provide exemptions to classes of covered persons, service providers, or consumer financial products or services.

The measure requires the CFPB to prevent a covered person from engaging in or committing an unfair, deceptive or abusive act or practice in connection with a transaction with a consumer for a consumer financial product or service. Current law prohibits unfair or deceptive acts or practices, but the addition of abusive act is designed to ensure that the CFPB is empowered to cover practices where providers unreasonably take advantage of consumers.

Risk Factors

In monitoring for risks, the CFPB considers a variety of risk factors including the extent to which the risks of a consumer financial product or service may disproportionately affect traditionally under-served consumers.

Independence & Funding

The measure makes clear that the CFPB would operate without any interference from the Fed, including with regards to rule writing, issuance of orders, examinations, enforcement actions, and appointment or removal of employees of the CFPB. This is a similar relationship to what exists between the Office of the Comptroller of the Currency (OCC), which is located within the Treasury Department.

The agreement makes funding for the CFPB independent of the congressional appropriations process, with the goal of increasing its independence. The measure requires the Fed to transfer the amount determined by the director to be reasonably necessary for the CFPB annual budget, but not to exceed a specified percentage of the total operating expenses of the Fed as reported in the 2009 Annual Report. As a percentage of Fed operating expenses, the CFPB funding would be capped at 10% for FY 2010, 11% for FY 2011 and 12% for FY 2013 and each year thereafter (adjusted for inflation).

The funding would be used to perform the following key functions — examinations and enforcement over larger banks, mortgage market companies, and other large covered non-depository companies; registration and reporting by non-depository companies that are subject to the CFPB examination authority; analytical support, monitoring and research, industry guidance and rulemaking; operation of a nationwide consumer complaint center; and consumer financial education.

State Law

Under the agreement, CFPB regulations would generally not pre-empt state law if the state law provides greater protection for consumers. Federal consumer financial laws have historically established only minimum standards and have not precluded the states from enacting more protective standards. This measure maintains this relationship, however, the measure clarifies instances when state law could be pre-empted in limited circumstances for national banks, federal savings associations and non-depository institutions.

The measure provides state attorneys general with the power to enforce CFPB regulations. State attorneys general and regulators would be directed to consult or notify the CFPB and the prudential regulators before initiating an enforcement action pursuant to this measure.

In general, the measure does not permit the attorney general of any state to bring a civil action in the name of such state against a national bank or federal savings institution unless it is to enforce a regulation prescribed by the CFPB under a provision of this measure or in other limited circumstances.

Under the agreement, the federal government, via the CFPB, would for the first time provide oversight of non-depository institutions. Under current law, supervisory authority over certain non-depository institutions is largely left to the states. The Federal Trade Commission's (FTC) authority to issue rules regarding unfair and deceptive practices is constrained by procedural requirements, and it does not have the authority to conduct compliance exams, as bank regulators do.

Certain individuals employed at non-depository institutions also would be subject to CFPB supervision, including those individuals that originate or service mortgage loans, as well as other consumer financial products. Personal tax advisers, attorneys, real estate agents, insurance professionals under state supervision and others, could be exempt from this provision under specified circumstances. Auto dealers engaging in the sale, servicing and leasing of motor vehicles also would be exempt from CFPB oversight.

The CFPB could require reports from, and conduct periodic examinations of, non-depository covered persons to assess compliance with federal consumer financial

laws, obtain information about activities and compliance systems, and detect and assess risks to consumers and markets for consumer financial products and services. The CFPB and the FTC would coordinate the enforcement action of non-depository mortgage actors, including civil actions.

Consumer Protection for Depository Institution Activities

The measure provides the CFPB with primary examination and enforcement authority related to consumer protection over all insured depository institutions and credit unions with more than $10 billion in assets. This authority would extend to the affiliates and service providers of these large depositories. Under current law, consumer protection jurisdiction and authority over the institutions is divided between many regulators whose mission is not focused on consumer protection, resulting in banks choosing the least restrictive consumer compliance supervisor.

The agreement creates one federal regulator with consolidated consumer protection authority over the largest depository institutions, thereby reducing the opportunity for regulatory arbitrage. The measure provides that smaller insured depository institutions (i.e., worth $10 billion in assets or less) and credit unions continue to be examined for consumer compliance by the listing prudential regulator.

CFPB Limitations

The measure permits that the Financial Stability Oversight Council to set aside a final regulation promulgated by the CFPB if, in the view of two-thirds of the council, the regulation puts the safety and soundness of the banking system or the stability of the financial system at risk. A decision by the council to set aside a regulation prescribed by the CFPB would make the regulation unenforceable.

Under the agreement, the CFPB could not exercise any authority with respect to a merchant, retailer, seller or broker of non-financial good or service. For example, persons and businesses such as dentists, doctors, small retailers, and others that simply allow their customers to pay bills over time are excluded from the CFPB's authority.

Data Collection

The measure authorizes the collection of deposit account data in order to promote awareness and understanding of the access of individuals and communities to financial services, and to identify business development needs and opportunities. It also authorizes the collection of data on small businesses to facilitate enforcement of fair lending laws and to enable communities, governmental entities and creditors to identify business and community development needs and opportunities for women-owned and minority-owned small businesses.

Student Loans

The agreement requires the Treasury Department, in consultation with the CFPB director, to designate a private education loan ombudsman within the CFPB to provide timely assistance to borrowers of private education loans, and to disseminate information about the availability and functions of the ombudsman to borrowers, potential borrowers, and related institutions, agencies, and participants. The measure also requires the CFPB to resolve complaints from borrowers of private student loans.

Reporting Requirements

The measure requires the CFPB director to appear before Congress at semi-annual hearings and, concurrently, to prepare and submit a report to the president and Congress concerning the CFPB budget and regulation, supervision and enforcement activities.

The CFPB budget would be subject to annual audits by the Government Accountability Office (GAO).

The measure requires the GAO to conduct a study on various appraisal methods and the extent to which the usage of such methods affects costs to consumers, conflicts of interest and home-price speculation.

The agreement requires the Treasury Department to conduct a study, with recommendations on options for ending the conservatorship of Fannie Mae and Freddie Mac. Options and priorities would include minimizing the cost to taxpayers, the gradual wind down and liquidation of such entities; the privatization of such entities; the incorporation of the functions of such entities into a federal agency; the dissolution of Fannie Mae and Freddie Mac into smaller companies; or any other measures the Treasury Department determines appropriate.

Section IV

Derivatives Regulation

This section describes the provisions of the conference report HR 4173 that concern the regulations of derivatives.

Derivatives & Swaps

Derivatives can take many forms, but in general they are contracts based on the underlying value of an asset, such as stocks, interest rates, currencies and commodities. Derivatives are often used by companies to hedge risk, but they can also be used for speculation. For example, an airline company may want to buy an oil futures contract, which is a type of derivative, as a means of hedging the risk that fuel prices will go up, which would increase costs for their business. Since they own a derivative on fuel prices though, the value of the contract will also go up if fuel prices rise and will therefore reduce the loss associated with rising fuel prices. Speculation in derivatives generally involves betting on the price movements of an underlying asset, often without owning the underlying asset and without trying to hedge risk.

A swap is a type of derivative that involves two counterparties exchanging the benefits of one party's security for the benefits of the other party's security. For example, an interest rate swap would involve one party promising the cash flows generated from their interest generating security in exchange for the cash flows from the other party's interest generating security, such as bonds.

Credit default swaps (CDS), which played a central role in the recent crisis, are different in that they operate more like insurance policies on bonds. For example, if an investor buys a CDS position on a company's bonds, then the investor would pay the person selling the CDS a premium, but if the company defaults on its bonds, then the person that bought the CDS position receives a payoff.

Summary of Derivatives Regulations

The agreement establishes a new regulatory framework to cover a broad range of participants and products in the over-the-counter derivatives market, requiring many routine derivatives to be traded on exchanges and routed through clearinghouses. Customized swaps could still be traded over-the-counter, but they would have to be reported to central repositories.

The measure imposes new capital, margin, reporting, record-keeping and business conduct rules on firms that deal in derivatives, requiring banks to "spin off" only their riskiest derivatives trading operations into affiliates.

Banks could keep operations for interest-rate swaps, foreign-exchange swaps, and gold and silver swaps among others, but would be required to move trading in agriculture, uncleared commodities, most metals, and energy swaps to their affiliates.

Conferees note their expectation is that the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) would have enforcement authority in their jurisdictions, while the prudential regulators would maintain exclusive authority to enforce provisions for capital and margin for banks and branches or agencies of foreign banks. Conferees also expect that public trade reporting of all cleared and uncleared swaps and security-based swaps will be made available in order to improve transparency and price discovery.

Regulatory Authority

The agreement directs the SEC and CFTC to consult and coordinate with one another when developing rules for the swaps and security-based swaps markets, respectively. The difference between swaps and security-based swaps is that swaps generally refer to contracts based on commodity oriented assets, while security-based swaps are based on a variety of assets including, company securities, interest rates and currencies. This section refers to them collectively as "swap products."

The CFTC would handle regulatory functions for swaps; swap dealers; major swap participants; swap data repositories; derivative clearing organizations with regard to swaps; persons associated with a swap dealer or major swap participants; eligible contract participants; or swap execution facilities.

The SEC would handle regulatory functions for security-based swaps; security-based swap dealers; major security-based swap participants; security-based swap data repositories; clearing agencies with regard to security based swaps; persons associated with a security based swap dealer or major security-based swap participant; eligible contract participants with regard to security-based swaps; or security-based swap execution facilities.

The measure requires both of the regulators to treat functionally or economically similar swap products or entities in a similar manner and to jointly prescribe regulations regarding mixed swaps that could fall under the jurisdiction of either agency.

The measure requires that the Financial Stability Oversight Council resolve any dispute between the CFTC and SEC in the event that the two agencies fail to jointly prescribe rules in a timely manner.

The agreement establishes a record-keeping requirement for swap product transactions that are not cleared.

Under the agreement, regulators would be responsible for registering participants in the market, including — dealers; major participants; clearing agencies; organizations; exchanges; swap execution facilities; and trade repositories.

Regulators would seek to identify ways in which the U.S. regulations of swap product markets and regulations employed by other countries could be harmonized.

Abusive Swaps

The measure allows regulators to collect information for any type of swap product and issue a report with respect to these products if they are determined to be detrimental to the stability of financial markets.

Prohibition of Government Financial Assistance to Swaps Entities

The measure aims to discourage depository institutions from engaging in derivatives activity. Depository institutions could be forced to move derivatives trading desks into non-bank affiliates or divest from these activities. (The Senate version of the bill included language authored by Sen. Blanche Lincoln, D-Ark., that was initially much more restrictive and would have forced banks to spin off all of their swap operations).

The measure prohibits the U.S government from providing financial assistance to any swap-based entity.

The prohibition would <u>not</u> apply to an insured depository institution containing a swap entity affiliate, as long as the insured depository institution is part of a bank holding company or savings and loan holding company that is supervised by the Federal Reserve.

The prohibition also would not apply to any insured depository institution that limits its swap product activities to hedging and similar risk mitigating activities directly related to the insured depository institutions activities.

The provision also would not apply to those that limit such activity to acting as a swaps entity for swap products involving assets that are permissible for investment by a national bank. Bank-permissible activities would not include acting as a swaps entity for credit default swaps, including swap products referencing the credit risk of asset-backed securities, unless the swap products are cleared by a derivatives clearing organization or a clearing agency that is registered as a derivatives clearing organization, or exempt from registration.

The agreement specifies that if an insured depository institution qualifies as a swaps entity and is subject to federal assistance prohibition, then the entity would have up to 24 months to divest the swaps entity or cease the activities that require registration as a

swaps entity. The prohibition would only apply to swap products entered into by an insured depository institution after the end of a transition period.

In the event that a swap entity is placed in receivership by the FDIC, the swap positions would be subject to the termination or transfer in accordance with applicable law prescribing the treatment of those contracts. No taxpayer funds would be used to prevent the receivership of any swap entity resulting from swap product activity of the swaps entity. Taxpayers would not bear losses for liquidating a swap entity.

The measure provides that the Financial Stability Oversight Council could determine when other regulatory provisions established by this agreement are insufficient in order to effectively mitigate systemic risk and protect taxpayers.

Swap Products Market Regulation

The measure requires the clearing of all over-the-counter derivative transactions between dealers and large-market participants, provided a clearinghouse accepts the derivative for clearing. Clearinghouses would examine the particulars of a derivative contract and, if it accepts the contract for clearing, would guarantee that both sides of the deal abide by the contract.

Any transaction that required to be cleared, and that includes parties that are either dealers (entities in the business of buying and selling derivatives for their own accounts) or major market participants (non-dealers who maintain substantial net positions outside of hedging purposes) would be executed on an exchange, registered swap execution facility, or a foreign swap execution facility.

Clearing and being traded on an exchange would make many of the details of a derivative contract — such as pricing — widely available.

The measure requires regulators to establish a date on which the clearing requirement would take effect.

Clearing Requirements

The measure deems it unlawful for any person to engage in a swap product transaction unless that person submits the swap product for clearing to a derivatives clearing organization that is registered under this measure or a derivatives clearing organization that is exempt from registration under this measure, if the swap product is required to be cleared.

The CFTC or SEC would review each swap product, or group, category, type, or class of swap product, and determine whether the swap product or group, category, type, or class of swaps should be required to be cleared.

The determination would be based on the following:

- The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data.

- The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded.

- The effect on the mitigation of systemic risk, taking into account the size of the market for a contract and the resources of the derivatives clearing organization available to clear the contract.

- The effect on competition, including appropriate fees and charges applied to clearing.

- The existence of reasonable legal certainty in the event of the insolvency of the relevant derivatives clearing organization or one or more of its clearing members with regard to the treatment of customer and swap product counterparty positions, funds, and property.

Exceptions

Swap products entered into before the date of the enactment of this provision would be exempt from the clearing requirements of this provision if they were reported to a registered swap product data repository, or to the CFTC or SEC, no later than 180 days after the effective date of this provision.

The measure provides that the clearing requirements would not apply to a swap product if one of the counterparties to the swap products is not a financial entity; is using swap products to hedge or mitigate commercial risk; and notifies the SEC or CFTC of how it generally meets its financial obligations associated with entering into non-cleared swap products.

An affiliate of a person that qualifies for an exception could qualify for the exception, but only if the affiliate uses the swap products to hedge or mitigate the

commercial risk of the person or other affiliate of the person that is not a financial entity. Financial entities would be understood to include:

- A swap dealer;
- a security-based swap dealer;
- a major swap participant;
- a major security-based swap participant;
- a commodity pool;
- a private fund;
- an employee benefit plan;
- a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature; and
- possibly small banks, savings associations, farm credit system institutions, and credit unions that the CFTC or SEC deem qualified.

The exception would not apply if the affiliate is a swap dealer; a security-based swap dealer; a major swap participant; a major security-based swap participant; an issuer that would be classified as an investment company; a commodity pool; or a bank holding company with over $50 billion in consolidated assets.

Foreign Exchange Swap Products

The measure establishes regulations for the foreign exchange swap product market, which is valued at roughly $60 trillion dollars and is the second largest component of the swap products market.

The Treasury secretary would determine whether to exempt foreign exchange swap products and foreign exchange forwards based on several factors including:

- Whether the required trading and clearing of foreign exchange swap products and foreign exchange forwards would create systemic risk, lower transparency, or threaten the financial stability.

- Whether foreign exchange swap product and foreign exchange forwards are already subject to a regulatory scheme that is materially comparable to what would be established by this measure for other classes of swap products.

- The extent to which bank regulators of participants in the foreign exchange market provide adequate supervision, including capital and margin requirements.

- The extent of adequate payment and settlement systems.

- The use of a potential exemption of foreign exchange swap products and foreign exchange forwards to evade otherwise applicable regulatory requirements.

Segregation of Funds

The measure prohibits the combination of swap product customer funds with the funds of a futures commission merchant or the use of such funds to margin, secure, or guarantee any trades or contracts of any swap product customer or person other than the customer.

For assets held as collateral in uncleared swap product transactions, the agreement requires that a dealer or major participant notify the counterparty of the dealer or major participant at the beginning of a transaction that the counterparty has the right to require segregation of the funds or other property supplied to margin, guarantee or secure the obligations of the counterparty.

The segregated account would be kept by an independent third-party custodian and would be designated as a segregated account for and on behalf of the counterparty.

Derivatives Clearing Organizations

The CFTC or SEC could exempt a derivatives clearing organization from registration for the clearing of swap products if the CFTC or SEC determines that the derivatives clearing organization is subject to comparable, comprehensive supervision and regulation by the CFTC or SEC or the appropriate government authorities in the home country of the organization.

The agreement provides that each derivatives clearing organization, through margin requirements and other risk control mechanisms, would limit the exposure of the

derivatives clearing organization to potential losses from defaults by members and participants of the derivatives clearing organization to ensure that the operations of the derivatives clearing organization would not be disrupted. The derivatives clearing organization also would ensure that non-defaulting members or participants would not be exposed to losses out of their control.

Conferees expect mandatory clearing of swap products for those trades that are eligible for clearing as determined by both the clearing houses and the regulators and mandatory trading on an exchange or swap product execution facility should the transactions be cleared and a facility will accept it for trading.

Swap Products Not Accepted by Derivatives Clearing Organizations

The measure requires that each swap product that is not accepted for clearing by any derivatives clearing organization be reported to a swap product data repository or, in the case in which there is no swap product data repository that would accept the swap product, to the CFTC or SEC.

Any individual or entity engaged in a swap product transaction that is not accepted by a derivatives clearing organization would be required to provide the CFTC or SEC with reports regarding the swap products held by the individual or entity. Proper books and records would have to be maintained, and would be subject to review by the CFTC or SEC.

Margin & Capital Requirements

Conferees note that regulators would have the authority to impose margin requirements only on dealers and major participants for uncleared swaps, adding safeguards to the system by ensuring dealers and major swap participants have adequate financial resources to meet obligations.

In consultation with the SEC or CFTC, swap product dealers and major swap product participants, including banks and non-banks, would establish capital requirements and both initial and variation margin requirements on all swap products that are not cleared by a registered derivatives clearing organization.

The measure requires that, when setting capital requirements for a person that is designated as a swap product dealer or a major swap product participant for a single type or single class or category of swap product or activities, regulators would take into account the risks associated with other types of swap products and the other activities that are not otherwise subject to regulation by virtue of the status of the person as a swap product dealer or a major swap participant.

In setting margin requirements, regulators would permit the use of non-cash collateral as long as it is consistent with preserving the financial integrity of markets trading swap products and preserving the stability of the U.S. financial system.

Position Limits

The agreement directs the CFTC or SEC to establish limits on the amount of positions, other than true hedge positions, that could be held by any person with respect to swap products.

A list of exempt commodities would be established within 180 days after the date of the enactment of this provision and a list of exempt agricultural commodities would be established within 270 days after the date of the enactment of this provision.

The agreement requires that, when establishing the position limits, the CFTC or SEC would specifically set limits on the number of positions that could be held by any person for the spot month, every other month, and the aggregate number of positions that could be held by any person for all months. The SEC and CFTC also would, to the maximum extent practicable, seek to diminish, eliminate or prevent excessive speculation; deter and prevent market manipulation, squeezes and corners; ensure sufficient market liquidity for hedgers; and ensure that the price discovery function of the underlying market is not disrupted.

Carbon Market Study

The measure establishes an interagency working group composed of the following members: the chairman of the CFTC; the Agriculture secretary; the Treasury secretary; the chairman of the SEC; the administrator of the EPA; the chairman of the Federal Energy Regulatory Commission; the commissioner of the Federal Trade Commission; and the administrator of the Energy Information Administration.

The agreement requires the interagency group to conduct a study and report to Congress on the oversight of existing and prospective carbon markets to ensure an efficient, secure, and transparent carbon market, including oversight of spot markets and derivative markets.

Section V

Executive Compensation, Hedge Funds & Insurance

This section describes the provisions of HR 4173, that eliminate current exemptions from Securities and Exchange Commission (SEC) registration requirements for advisers of hedge funds; require all publicly traded companies to permit shareholders to conduct a non-binding vote on the compensation of company executives; establish the Federal Insurance Office; improve access to mainstream financial institutions; specify TARP funds repayment and restrictions; and limit funding for foreign governments. Many of these provisions were taken from Senate version of the bill, and later modified during conference committee negotiations.

Executive Compensation/'Say on Pay'

The measure requires publicly traded corporations to allow shareholders to take non-binding votes during annual meetings on the "top five" executive compensation packages, i.e., the executives with the five highest compensation levels.

The agreement is designed to address shareholder rights and executive compensation practices by providing shareholders in a public company with a vote on executive compensation — known as "say on pay" — and additional disclosures involving compensation practices. The measure prohibits brokers who are not beneficial owners of a security from voting through company proxies unless the beneficial owner has instructed the broker to vote on the owner's behalf.

In an effort not to disproportionately burden small issuers, the measure provides that small issuers also could be exempt from this provision.

The measure provides that national securities exchanges or a national securities associations could exempt a category of issuers from these requirements.

Under the agreement, at least every three years shareholders could cast an advisory vote to approve the compensation of executives, and the agreement also allows for votes on any "generous severance packages for outgoing executives in the event of a merger or acquisition.

The measure stipulates that the shareholder vote would be an advisory vote and would not be binding on the issuer or the board of directors of an issuer. The vote would not overrule a decision by such issuer or board of directors; create or imply any change to the fiduciary duties of such issuer or board of directors; create or imply any additional fiduciary duties for such issuer or board of directors; or restrict or limit the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation.

Independence, Disclosures & Clawbacks

The measure also requires a series of steps to prevent a potential conflict of interest for board members, expands disclosure requirements and provides for the potential "clawback" of compensation in specified circumstances. Specifically, the measure requires the following:

- Board committees that set compensation policy could consist only of directors who are independent, and any compensation consultants that are hired also would be independent;

- companies would tell shareholders about the relationship between the executive compensation the company paid and the company's financial performance;

- companies would be required to have a policy to recover money erroneously paid to executives based on finances that later have to be restated due to an accounting error; and

- Companies will be required to disclose in the annual proxy statement whether employees or members of the board may hedge or offset any decrease in the market value of equity securities granted.

Conferees note that they also expect federal financial regulators to monitor incentive-based payment arrangements of federally regulated financial institutions that exceed $1 billion and prohibit incentive-based payment arrangements that the regulators determine jointly could threaten financial institutions' safety and soundness or could have serious adverse effects on economic conditions or financial stability.

Hedge Fund Registration

The agreement eliminates current exemptions from SEC registration requirements for advisers of hedge funds and private equity firms, which are lightly regulated pools of capital with a limited number of investors that often use aggressive trading or investment strategies. The agreement aims to eliminate a perceived regulatory gap and increases the record keeping, examination and disclosure requirements for hedge funds and private equity firms. The measure also increases the SEC's ability to take and enforce actions against these firms if necessary.

Conferees expect this measure to eliminate the "private adviser" exemption in the Investment Advisers Act of 1940 (PL 76-768) thus registering advisers to private funds with the SEC. Conferees expect the SEC to take into account the size, governance and investment strategy of an adviser to the fund to determine if the fund poses a systemic risk and expects investment advisers to disclose the identity, investments or affairs of their clients for purposes of systemic risk.

Exemptions

Research indicates that nearly 55% of hedge funds are already registered with the SEC. Under current law, advisers with fewer than 15 clients are exempted from the registration requirement and a hedge fund is counted as a single client even if there are multiple investors invested in the hedge fund. This allows many advisers to escape the SEC registration requirement. The agreement eliminates this exemption.

Under current law, advisers with less than $30 million in assets under management do not have to register with the SEC; however, this measure increases that threshold to $100 million. Advisers with less than this amount would be the responsibility of the state, allowing the SEC to focus its examination efforts for private funds and improve its performance for catching fraud, which has been heavily criticized in recent years.

The measure provides an exemption for foreign private advisers, adds a limited intrastate exemption, and exempts small business investment companies licensed by the Small Business Administration (SBA).

The agreement provides a registration exemption for venture capital firms. The SEC requires that venture capital firms maintain records and provide the SEC with reports that are necessary to protect the public interest.

The measure also exempts from SEC registration investment advisers of <u>private funds</u> with less than $150 million in assets under management.

Reporting Requirements & Safeguarding Client Assets

The agreement requires advisers to submit reports to the SEC that describe the amount of assets under management; the amount of leverage used; counterparty risk exposure; trading and investment positions; valuation policies; types of assets held; and other information the SEC deems to be important.

The measure requires the SEC to report to Congress annually on how it has used the information it has collected.

As a means of reducing Bernie Madoff like ponzi schemes in the future, the agreement requires advisers to ensure the safeguard of client assets that the adviser has custody. As part of this requirement, the adviser would seek verification of assets under custody by an independent public accountant.

Accredited Investors

Under current law, investors must be considered to be "accredited investors" in order to invest in a private fund. The belief is that these investors are more sophisticated and do not require the same level of protection that other individual investors may need. Current law considers accredited investors to have an annual income of at least a $200,000 and a net worth of at least $1 million, which may include the value of an individuals primary residence. Since these requirements were established, inflation and the appreciation of home values may have made these thresholds inappropriately small.

This measure prevents home values from counting in the net worth calculation and directs the SEC to review, every four years, the definition of an accredited investor and establish new thresholds if necessary.

GAO & SEC Studies

The agreement requires the Government Accountability Office (GAO) to conduct a study on the accredited investors definition, the feasibility of creating a new private fund self-regulatory organization (SRO) and the annual cost of investor registration requirements.

It directs the SEC to conduct a study on short selling, which is selling a stock you do not own in the hopes that the stock value will decline so that you may sell the shares back and keep the difference in value as a profit. The study would look at current SEC short-selling rules, recent incidence of failure to deliver, the practice of delivering shares sold short on the fourth day following the trade, and a consideration of real time reporting of short positions.

Federal Insurance Office

The agreement establishes the Federal Insurance Office within the Treasury Department with a director appointed by the Treasury secretary as the office's head. The director would also serve as an advisor on the Financial Stability Oversight Council created by the bill. The new office would have the following responsibilities:

- Monitor all aspects of the insurance industry;
- making recommendations to the council that certain

insurers would be designated as non-bank financial institutions and subject to Federal Reserve supervision;

- assisting department administration of the Terrorism Risk Insurance Program;

- coordinating federal efforts and establishing federal policy on prudential aspects of international insurance matters. Relevant congressional committees and the U.S. Trade Representative would also be involved in this process;

- determining whether matters concerning state insurance issues would be pre-empted by international insurance agreements; and

- consulting with states on insurance matters of national importance.

The office would handle all lines of insurance, except crop insurance, long-term care insurance and health insurance.

The agreement requires that traditionally underserved communities have sufficiently affordable access to all lines of insurance — except health insurance — where the measure remains silent.

Conferees point out that the office is not a federal regulator or supervisor of insurance. Its functions include collecting information about the insurance industry; monitoring for systemic risk in the insurance industry, including serving in an advisory capacity to the council; and administering the Terrorism Risk Insurance Program. Conferees expect the office will consult with the states regarding insurance matters of national importance and prudential insurance matters of international importance and will also coordinate federal efforts and develop federal policy on prudential aspects of international insurance matters. Conferees also expect the office will have a narrow and limited pre-emption power over state insurance measures that are inconsistent with such international insurance agreements.

Data Gathering

The office could request that insurers submit "reasonable" data that would allow the office to carry out its functions. The data requests would be coordinated with the relevant state regulator and the office would have the power to issue subpoenas. Conferees expect this action to be used as a last resort.

Pre-emption of State Law

The measure places restrictions on pre-empting state insurance and consumer protection laws. The agreement prevents national insurance regulators from establishing regulations for insurance rates, premium limits, sales and underwriting practices, state antitrust laws and capital or solvency requirements.

Non-Admitted Insurance

The agreement provides the insurance regulator in an insurer's home state with sole regulatory authority over non-admitted insurance, including the collection and allocation of premium tax obligations. Non-admitted insurance provides coverage for unusual risks typically unavailable in the traditional insurance marketplace. The majority of these policies are purchased by sophisticated commercial entities to cover commercial risk, though some individuals also purchase coverage in the non-admitted market.

Conferees state they intend each state to adopt nationwide uniform requirements, forms and procedures, providing for the reporting, payment, collection and allocation of premium taxes for non-admitted insurance.

The measure stipulates that no state, other than an insurer's home state, could require a surplus lines broker to be licensed in order to sell, solicit or negotiate non-admitted insurance.

After a two year transition period from the enactment date of this measure, the agreement prohibits states from collecting licensing fees for non-admitted insurance brokers unless the state participates in the national insurance producer database of the National Association of Insurance Commissioners (NAIC). The measure creates uniform eligibility requirements for non-admitted insurance providers and streamlines the application procedures for commercial purchasers.

Reinsurance Market

The measure regulates the reinsurance market — the market of insurance that insurance companies buy to reduce their own risk — by limiting the ability of one state to deny credit for reinsurance to another state if the insurer's home state is an NAIC accredited state or has solvency requirements substantially similar to NAIC guidelines. The measure also prohibits states from restricting the dispute settlement rights of reinsurers located in another state and either ignoring, eliminating or unilaterally changing contracts.

Under the agreement, if the insurer's home state is an NAIC accredited state or has solvency requirements substantially similar to NAIC guidelines then the home state would be solely responsible for regulating the financial solvency of the reinsurer.

Studies

The measure requires the Federal Insurance Office to submit a report to Congress on steps that could be taken to modernize and improve insurance regulation. The report would discuss insurance systemic risk, capital standards, insurance consumer protection, national uniformity of state insurance regulation and international coordination. The report would be submitted within 18 months of enactment.

The office would submit a report to Congress and the president on the insurance industry and actions taken by the office regarding pre-emption of inconsistent state insurance measures.

The agreement requires the office to conduct a study on the non-admitted insurance market and reinsurance market. The GAO also would review these markets.

Improving Access to Mainstream Financial Institutions

The agreement contains initiatives intended to provide financial products and services that are appropriate and accessible for many individuals who are not fully incorporated into the financial mainstream, such as, "underbanked" consumers who rely on non-traditional forms of credit and are often unable to save securely for future financial needs, such as education expenses.

Conferees expect the measure to expand access to safe and affordable bank accounts, credit and financial information for low-income, minority and other underserved families. The measure also creates a pool of capital to enable community development financial institutions to establish and maintain small dollar loan programs, creating an alternative to pay day or car title loans in local communities.

Eligibility & Funding

The agreement authorizes the Treasury Department to establish a multi-year program of grants, cooperative agreements, financial agency agreements, and similar contracts or undertakings to promote initiatives designed to expand access for low and moderate income individuals to mainstream financial institutions.

The measure permits eligible entities, including nonprofit organizations, federally insured depository institutions, community development financial institutions, state and local governments, tribal entities and certain partnerships and joint ventures that receive grants to offer products or services — including small-dollar value loans and financial education and counseling — to low and moderate income individuals.

Under the agreement, entitles receiving grants from the Treasury Department would provide non-federal matching funds equal to 50% of the amount of any grant received. In addition, entities receiving grants could not provide direct loans to consumers.

The agreement requires the Treasury Department to submit a report to Congress on the grant program activities.

TARP Repayment & Use of Unused Stimulus Funds

The 2008 Emergency Economic Stabilization Act (PL 110-343; See House Action Reports Fact Sheet No. 110-45, October 2, 2008) created the Troubled Asset Relief Program (TARP). Through TARP, the Treasury Department was authorized to buy residential or commercial mortgages; any securities, obligations, or other instruments related to such mortgages that were originated prior to March 14, 2008; and any other instrument it determines is necessary to "promote financial market stability," including equity interests in a company. The TARP authority has been used to make multibillion dollar equity investments in financial institutions, including JP Morgan Chase, Goldman Sachs and Citigroup, as well as General Motors and Chrysler.

The 2008 law authorized the department to make up to $700 billion in investments, although subsequent laws made reductions to the authority to offset other costs of other programs.

The agreement reduces the authorization to $475 billion, and it prevents unspent TARP funds from being redirected to new spending.

The measure requires the proceeds from the sale of assets obtained through TARP — including Freddie and Fannie Mac and Home Loan Banks — as well as fees generated as a result of TARP to be returned to the Treasury and used to help reduce the nations's deficit.

The measure requires that none of the funds detailed in this provision be used as a budget offset for spending increases or revenue reductions.

The agreement requires that unspent funds from the stimulus law (PL 111-5) be returned to the Treasury by Dec. 31, 2012, and used to help reduce the nations' deficit. It permits the president to waive these requirements if the president determines that it is not in the best interest of the nation to rescind a specific unobligated amount.

Restrictions on Providing Funds to Foreign Governments

The measure amends the Bretton Wood Agreement Act (PL 79-171) to require the Treasury secretary to instruct the U.S. executive director of the International Monetary Fund (IMF) to review any IMF proposals that would issue a loan to a country whose public debt is higher than its recent annual gross domestic product (GDP) or to a country that is not eligible for assistance from the International Development Association. If the review indicates that the loan is not likely to be paid in full, then the director would be directed to oppose the loan.

Conflict Minerals in Congo

The agreement requires companies to disclose to the SEC if minerals extracted during the course of their business operations originated in the Democratic Republic of Congo and adjoining countries. The disclosure report would describe the measures taken to exercise due diligence on the source and chain of custody of the minerals. The conference report requires the U.S. government to develop a strategy to address the illicit minerals trade in the region, and a map to address linkages between conflict minerals and armed groups.

Coal Mine Safety

The agreement requires mining companies to disclose mining safety violations that are material to investors.

Payments by Resource Extraction Issuers

The measure requires public disclosure to the SEC of any payment relating to the commercial development of oil, natural gas and minerals made by any person to the U.S. or a foreign government.

Section VI

Interchange Fees, Mortgage Lending & Other Provisions

This section describes the provisions of the conference report on HR 4173 that limit the fees banks can charge retailers on debit card transactions; requires the Security and Exchange Commission (SEC) to review annually the practices of credit ratings agencies; enhance SEC management; ensure greater protection for investors; securitization practices; and reform mortgage lending.

Interchange Debit Fees

The agreement limits the amount that banks and payment networks could charge retailers for using debit cards and the debit card transaction network.

The measure provides that debit cards would be understood to include any card approved for use through a payment card network to debit an asset account, as well as general-use prepaid cards, but would not include paper checks.

The measure permits the Federal Reserve (the Fed) to issue regulations regarding any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction.

The agreement requires that the amount of any interchange transaction fee that an issuer could receive or charge with respect to an electronic debit transaction would be reasonable and proportional to the cost incurred by the issuer with respect to the transaction.

Exemptions

The agreement provides an exemption to this provision for any issuer that has less than $10 billion in assets. It also exempts debit cards or general-use pre-paid cards that have been provided to a person pursuant to a federal, state or local government-administered payment program, in which the person may only use the debit card or general-use prepaid card to transfer debit funds, monetary value, or other assets that have been provided pursuant to the government program.

Information Requests

The Fed could require any issuer or payment card network to provide information necessary to carry out the interchange fee provisions.

Credit Rating Agencies

Credit rating agencies evaluate the relative risk of default of various securities and debt instruments. They play a critical gatekeeper role in the debt market that is

functionally similar to that of securities analysts, who evaluate the quality of securities in the equity market, and auditors, who review the financial statements of firms. Currently, agencies are required to register with the SEC. The measure assumes that this role requires a similar level of public oversight and accountability for credit rating agencies that these similar professions face.

The measure provides the the SEC with broader powers to regulate credit rating agencies, also knows as nationally recognized statistical rating organizations (NRSROs).

Establishment of SEC Office & Rules for Agencies

Under the agreement, a new Office of Credit Ratings would be established in the SEC. The office would examine credit rating agencies at least once a year and make key findings public.

The SEC would provide new rules that would require credit rating agencies to do the following:

- Set up internal controls over the process for determining credit ratings;
- establish an independent board of directors;
- make greater disclosures to the public and investors; and
- develop universal ratings across asset classes and types of issuer.

If the credit rating agencies prove to provide bad ratings over time, then the agreement provides the SEC with the authority to de-register that firm.

Credit Rating Models

The measure requires that each credit rating agency discloses — information relating to the assumptions underlying the credit rating procedures and methodologies; the data that was relied on to determine the credit rating; if applicable, how the agency used servicer or remittance reports to conduct surveillance of the credit rating and with what frequency; and information that could be used by investors and other users of credit ratings to better understand credit ratings in each class of credit rating issued by the rating agency.

Conflicts of Interest

The agreement includes provisions to address various conflicts of interest inherent within the ratings business. Specifically, the measure requires rating agencies to do the following:

- Prohibit compliance officers from working on ratings, methodologies, or sales. Prevent other employees from both marketing ratings services and performing the ratings of securities.

- Conduct a one-year look-back review when an agency employee goes to work for a company that offers or underwrites a security or money-market instrument subject to a rating by that rating agency.

- Report to the SEC when certain employees of the rating agency go to work for an entity that the agency has rated in the previous 12 months.

Reliance of Ratings

To reduce the reliance on ratings, the agreement requires that references to credit ratings be removed from certain regulations, policies and procedures that federal agencies use. The agencies would use a new standard to judge creditworthiness in place of the credit rating provided by a rating agency.

Credit ratings are also often embedded into debt contracts, certain derivatives and prior to recent financial crisis, were going to be relied on in the Basel II Accord on international regulation that is still being negotiated. The measure is silent on these items.

Investor Lawsuits

The agreement provides investors with a private right of action to bring suit against credit rating agencies for a knowing or reckless failure to conduct a reasonable investigation of the facts or to obtain analysis from an independent source.

Structured Product Ratings

The agreement directs the SEC to establish a system that prohibits issuers of structured finance from selecting the rating agency that provides the initial credit rating. This practice was common in the rating of various mortgage related asset-backed securities and collateralized debt obligations (CDO) that played a central role in the

recent financial crisis. Many of these structured products turned out to have a much poorer credit quality than what the rating agencies had designated.

Conferees expect the system would mandate that initial rating assignments for structured financial securities be made on a random or semi-random basis, unless the SEC determines after a study that an alternative system of assigning ratings would better protect investors and serve the public interest.

New Mortgage Rules & Predatory Lending Restrictions

The agreement establishes minimum national standards for mortgage brokers and institutions, including banks, that provide home mortgages. The standards would be issued as regulations by the Bureau of Consumer Financial Protection and would include requirements that a lender or originator of a home loan would have to ensure that a borrower has a reasonable ability to repay the loan, at the time the loan is made. That determination would have to be made based on verified and documented information, including the borrower's credit history, income and other factors.

Safe Harbor

Certain low-risk loans, called "qualified mortgages," would be exempt from the measure's loan standards. A qualified mortgage would be a mortgage with a term of 30 years or less, and it could not allow the delay of the payment of principal or an increase in the principal balance, among other requirements.

Pre-payment Penalties

The measure prohibits pre-payment penalties for any mortgage that does not meet the safe harbor standards for a qualified mortgage. Pre-payment penalties are fees paid by borrowers for repaying loan principal ahead of schedule. Under the agreement, when a loan is first made, originators would have to offer a version of the loan that does not include a pre-payment penalty.

For mortgages that meet the measure's underwriting standards, the agreement limits pre-payment penalties in the following ways:

- In the first year of the loan, penalties could not exceed 3% of the outstanding balance.
- In the second year, penalties could not exceed 2% of the outstanding balance, and penalties could not rise above 1% in the third year of the loan.

- After that three-year period, no pre-payment penalties may be assessed.

Anti-Steering

The agreement bars any financial incentives, including payments known as "yield spread premiums," that lenders pay to mortgage brokers for selling loans with higher interest rates. Mortgage originators would not be able to receive payment that varies based on the terms of the loan, other than the amount of the principal.

Lender Liability

The measure allows for liability action against mortgage originators that violate their obligations under the agreement, and provides for a maximum liability, per violation, of up to three times the total amount of lender fees, plus the consumer's costs including reasonable attorney fees.

High-Cost Home Loans

The Home Ownership and Equity Protection Act of 1994 (HOEPA; PL 103-325) addressed certain deceptive and unfair practices in home equity lending by establishing requirements for certain loans with high interest rates and/or high fees. The law affects refinancing and home equity installment loans that also meet the definition of a high-rate or high-fee loan. The law does not cover loans to buy or build homes, reverse mortgages or home equity lines of credit.

The agreement defines "high-cost home loans" as a primary residence mortgage with an annual interest rate higher than 6.5% — or 8.5% if the dwelling is personal property and the loan is smaller than $50,000. For a second mortgage or other subordinate loan on the property, a mortgage with an annual percentage rate of higher than 8.5% would qualify as a high cost mortgage.

The measure bars balloon payments for high-cost mortgages, which include scheduled mortgage payments that are more than twice as large as the average of earlier scheduled payments. It prohibits defaulting on an existing loan that is being refinanced by a high-cost loan. It limits late fees to no more than 4% of the amount of payment past due, along with other restrictions. No high-cost loan could accelerate the indebtedness of a loan. No lender could directly or indirectly finance, in connection with any high-cost mortgage, any prepayment fee or penalty payable by the borrower if the lender holds the note for the underlying loan.

Before a borrower takes a high-cost loan, the lender would have to receive certification from a counselor that the borrower has received counseling on the

advisability of the mortgage. The counselor could not work for the lender or be affiliated with the lender.

Housing Counseling Office

The measure requires all higher-cost mortgage borrowers to have escrow accounts.

The agreement creates an Office of Housing Counseling at the Department of Housing and Urban Development (HUD) that would carry out and coordinate homeownership and rental housing counseling programs. It sets up a national public service campaign to promote housing counseling and establish a website and toll-free hotline for counseling.

It authorizes $3 million each year for FY 2009, FY 2010, and FY 2011, for the national campaign. It authorizes homeownership and rental housing counseling grants to HUD-approved housing counseling agencies and state housing finance agencies, and authorizes $45 million for each of FY 2009 through FY 2012 for the grants.

Housing Appraisals.

The agreement prohibits lenders from making high-cost loans without first getting a written appraisal of the property. All parties to a real estate transaction would be prohibited from influencing the independent judgment of an appraiser through collusion, coercion and bribery, among other activities. The measure make available such sums as may be necessary to provide $1 billion in assistance through the Emergency Homeowners Relief Fund, which HUD would establish to provide emergency mortgage assistance through loans to homeowners who have lost their jobs to help make loan payments while the borrower is out of work.

It also appropriates $1 billion for a third round of funding for the Neighborhood Stabilization Program, through which HUD assists state and local government efforts to finance the purchase and redevelopment of foreclosed homes and residential properties. In addition, the measure authorizes a HUD-administered grant program to help entities that provide legal assistance to low- and moderate-income recipients on homeownership preservation, foreclosure prevention, and the rights of tenants associated with home foreclosure.

Investor Protection

The agreement imposes new standards for investment advisers and broker-dealers, increases the authorized funding for the SEC over the next five years and expands the commission's authority to set more stringent rules to protect investors.

The measure creates an Office of Investor Advocate and an ombudsman at the SEC in order to help facilitate a productive relationship between investors and the SEC.

The measure provides additional protections for retail investors by directing the SEC to study the standards of care applicable to broker-dealers and investment advisers giving investment advice to retail customers.

The measure stipulates that retail investors would include a person who receives personalized investment advice about securities from a broker or dealer or investment adviser and uses the advice primarily for personal, family or household purposes.

The measure permits the SEC to place a fiduciary duty on broker-dealers and investment advisers to protect retail customers.

The measure requires several studies to be conducted, including studies on the enhancement of investment adviser examinations, financial literacy, mutual fund advertising, conflicts of interest, improved investor access to information on investment advisers and broker-dealers and financial planners, and the use of financial designations.

Increasing Regulatory Enforcement & Remedies

The agreement provides the SEC with additional authority to conduct investigations, asses penalties and violations, and impose enforcement actions.

An investor protection fund would be established in the Treasury and used to pay awards to whistleblowers. It also would fund the activities of the inspector general of the SEC.

The measure provides incentives and protections for whistleblowers, who provide information relating to a violation of the securities laws that leads to successful SEC enforcement actions. Whistleblowers would receive awards ranging from 10% to 30% of the amounts collected by the SEC in actions where the SEC obtained monetary sanctions exceeding $1 million.

The agreement enhances the ability of the SEC to ban violators from all parts of the securities industry, and it disqualifies felons and other bad actors from using the Regulation D exemption, which is an exemption from having to register securities with the SEC that is used by small companies and startups.

The measure provides for the equal treatment of self-regulatory organization (SRO) rules and streamlines SRO rule filing procedures by requiring the SEC to complete the process of reviewing and taking action on proposed SRO rules within specified time frames.

The agreement updates laws related to the Securities Investor Protection Corporation (SIPC) by increasing the minimum assessments on SIPC members, raising penalties for fraud, and establishing civil and criminal penalties against any person who misrepresents membership in SIPC.

The agreement increases the limit on SIPC borrowing from the Treasury Department to $2.5 billion from $1 billion.

The measure gives the SEC authority to enhance public reporting of aggregate information on short selling, prohibit manipulative short sales, and require notification to customers that they could choose not to allow their securities to be used in connection with short sales.

Securitization

Securitization involves the process of turning a non-marketable asset into a marketable asset. Different loan-oriented assets are packaged together —usually corporate loans, mortgages, corporate bonds — and are then split into groups or "tranches." Bonds are issued from those tranches and are secured by the cash-flows generated from the underlying assets.

The tranches carry different risk-return profiles, so that the tranche paying the highest interest on its bonds is also be considered the riskiest and in greatest risk of defaulting on its obligations. This process was heavily used in the packaging of subprime mortgage bonds and has also been used significantly for a variety of purposes on Wall Street and in the corporate world. Securitization greatly changed the nature and perception of risk, lowered the cost of capital for firms, and allowed financial institutions to free up more capital than they otherwise would have been able. Some argue, however, that securitization perpetuated the process of making imprudent loans to individuals.

This agreement requires securitizers to retain an economic interest in a material portion of the credit risk for any asset that securitizers transfer, sell or convey to a third party. In general, securitization would have to retain at least 5% of the credit risk. Securitized assets with lower risk, could, however, be given an alternative minimum level at the discretion of regulators. The expectation is that this requirement would force securitizers to focus more on the quality of the underlying assets that are being securitized, thereby reducing excessive risk taking.

The agreement allows regulators to determine risk retention requirements and exemptions, which would include setting risk retention requirements for different asset classes that are securitized and allocating risk retention obligations between securitizers and originators.

The agreement also enhances disclosure requirements by issuers of asset-backed securities, including data related to the underlying loans or assets.

Exemptions

The measure provides exemptions for the Farm Credit System and any residential, multi-family, or health care facility mortgage loan asset or securitization which is insured or guaranteed by the federal government.

The agreement requires regulators to issue total or partial exemptions from risk retention and disclosure requirements for municipal securities and for securitizations of assets issued or guaranteed by federal agencies, as long as the exemption is in the public interest and for the protection of investors.

SEC Management

The agreement requires the completion of several reports assessing the management of the SEC related to internal supervisory controls, personnel management, financial controls, and oversight of national securities associations, which would assess SEC performance and provide recommendations for improvements.

The measure recommends that a new program at the SEC be created, requiring the Divisions of Trading and Markets and Investment Management to have examiners on their staffs to perform compliance inspections.

Under the agreement, the SEC would hire a consultant to study the SEC's operations and determine whether there is a need for comprehensive changes.

The measure requires the SEC to establish a telephone hotline, or other electronic means for receiving suggestions by employees for improvements in work efficiency, effectiveness, productivity and allegations by employees of waste, abuse, misconduct, or mismanagement by the SEC. The identities of anyone using the hotline would remain confidential.

The measure requires several studies, including one by the GAO that reviews SEC employees that leave and go to work for a financial institution and the implications that this practice may have.

Other Provisions

Corporate Governance

The agreement aims to improve proxy access to shareholders so that they have a broader range of candidates that they can nominate to a company's board of directors.

When drafting proxy access rules, the measure requires the SEC to consider the burden on small issuers, and may issue exemptions from proxy access rules. Issuers must also disclose why the issuer has chosen to have a single person, or different individuals, serve as CEO and chairman of the board of the company.

Municipal Securities

The measure requires the registration of municipal financial advisors and subjects them to Municipal Securities Rulemaking Board (MSRB) rules. The agreement reconstitutes the MSRB to require that a majority of members are independent of the municipal securities industry. Municipal advisors will have a fiduciary duty to municipal entities.

The agreement also creates an Office of Municipal Securities within the SEC.

The measure calls for studies of municipal securities markets, and ways to increase disclosure to investors.

Public Accounting Oversight Board

The agreement allows the Public Company Accounting Oversight Board (PCAOB) to examine the auditors of broker-dealers and share information with foreign authorities.

The agreement authorizes portfolio margining — collateral that a customer must post for their holdings — for accounts that hold both securities and futures. It also raises the dollar threshold that triggers a full "material loss review" of the Deposit Insurance Fund by federal banking regulators.

The measure exempts small issuers — those with less than $75 million in market capitalization — from the external audit of internal controls requirements of the 2002 Sarbanes-Oxley law (PL 107-204). It also creates an exemption for certain annuities from federal securities regulation.

Conferees note their expectation is that this provision would improve transparency and address the problems related to securities borrowing and lending. Conferees also expect the measure would improve the coordination, activities, flexibility and accountability of inspectors general at federal financial agencies.

SEC Match Funding

Conferees note their expectation is that the measure maintains the role of the appropriations committees in Congress in setting the SEC's annual budgets on and after FY 2012.

The agreement provides that transaction fee receipts would be treated as offsetting collections equal to the amount of the appropriation. Any excess collections would go to the Treasury Department as general revenue and could not offset any current or future appropriations. The rates would be reviewed midyear and if it is determined that the rates could produce 10% more or less than expected, then they would be adjusted.

The agreement sets registration fee targets that are expected to produce $5 billion of revenues over ten years that will go to the Treasury general fund. It also requires SEC's budget to be submitted to Congress concurrent with the earliest submission to the Office of Management and Budget and submitted unaltered by the president; provides flexibility for multi-year budget authority and unanticipated needs; and authorizes graduated funding level increases for the SEC over the period from FY 2011 through FY 2015.