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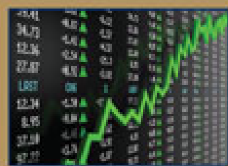

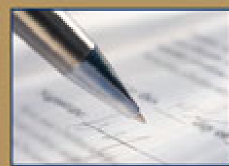

OVERVIEW
Dodd-Frank
Financial Reform Act

AUGUST 2010

# Preparing for Life After Financial Reform

## An Overview of the Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") is the most dramatic financial services law since the Great Depression. This massive piece of legislation impacts banks, thrift institutions, insurance companies, hedge funds, rating agencies, nondepository financial service providers, and the regulators who have supervised, or will now supervise, these entities. Mortgage loans, securities, derivatives, insurance products, credit cards, commercial loans, and consumer loans will now be delivered under a new set of rules.
One notable point about this new law is that the exact nature and extent of these changes cannot be found within the more than 2,300 pages of this new law. Guidance as to the full detail of this financial reform bill will be ascertained only when countless rules, regulations, studies, reports, and interpretations come into focus over the coming months and years.

Accordingly, the following overview provides a high-level analysis of the 14 financial reform-related titles of the Act. For those who wish to delve into the Act itself, links to the titles are included. Be forewarned, despite the Act's objective of increasing "transparency," the Act is not written in "plain language." We will be issuing periodic updates about the Act as the law evolves. Our attorneys are available at all times to help our clients understand, prepare for, and comply with the new legislation.

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## TITLE I - FINANCIAL STABILITY

### A. Financial Stability Oversight Council

Title I provides for the establishment of two new federal regulatory agencies charged with the responsibility for maintaining the stability of the U.S. financial system.

The responsibilities of the Financial Stability Oversight Council (FSOC) include the identification of "systemically important" non-bank financial companies, to be placed under Federal Reserve (the Fed) regulation and subjected to heightened prudential standards. Title I also provides that the FSOC will promote market discipline and respond to emerging threats to U.S. financial markets from risks associated with the material distress or failure, or ongoing activities, of large, interconnected bank holding companies or non-bank financial companies, or from risks that could arise outside the financial services marketplace. The FSOC will comprise 10 voting and 5 nonvoting members. The voting members include representatives of all of the existing federal financial regulators. The nonvoting advisory members include state banking, securities, and insurance regulators.

### B. Office of Financial Research

Title I also establishes the Office of Financial Research (OFR) within the Treasury Department. The OFR is responsible for supporting the FSOC's objectives by providing research, data collection, risk measurement and monitoring, and other related services.

### C. Additional Board of Governors Authority for Certain Non-Bank Financial Companies and Bank Holding Companies

Title I equips the Fed with new authority to require non-bank financial companies, and their subsidiaries, to submit reports concerning their financial condition, systems, and compliance. These companies are also subject to examination by the Fed and to formal regulatory enforcement mechanisms under the Federal Deposit Insurance Act.

Link to Text of Title I

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## TITLE II - ORDERLY LIQUIDATION AUTHORITY (OLA)

Title II provides for the creation of an orderly liquidation authority that will enable the FDIC&#151as a receiver&#151to seize control of, and liquidate, "covered financial companies" once a determination is made that the company poses a systemic risk to the financial system. This new power, designed to address the issues posed by companies that otherwise might be considered "too big to fail," preempts any proceedings under the United States Bankruptcy Code. An OLA action is solely a liquidation remedy and does not allow for rehabilitation or reorganization of a "covered financial company." While insurance companies subject to state regulation are exempted from the OLA, their unregulated affiliates and holding companies are not.

Link to Text of Title II

## TITLE III - TRANSFER OF POWERS TO THE COMPTROLLER OF THE CURRENCY, THE CORPORATION AND THE BOARD OF GOVERNORS

### A. Transfer of Powers and Duties

Title III, the "Enhancing Financial Institutions Safety and Soundness Act of 2010," transfers the functions of the Office of Thrift Supervision to the Office of the Comptroller of the Currency, the Federal Reserve, and the FDIC and abolishes the OTS 90 days after its functions are transferred. The transfer of powers and duties will become effective anyw from one year to 18 months after the date of enactment.

### B. Federal Deposit Insurance Corporation

Title III also amends the Federal Deposit Insurance Act to implement various reforms relating to deposit insurance assessments and reserve ratios. In addition, Title III permanently increases the maximum deposit insurance limit from $100,000 to $250,000.

### C. Other Matters

Under Subtitle D of Title III, each federal financial regulatory agency on the FSOC is required to establish an Office of Minority and Women Inclusion responsible for all agency matters relating to diversity in management, employment and business activities.

Link to Text of Title III

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## TITLE IV - REGULATION OF ADVISERS TO HEDGE FUNDS AND OTHERS

Title IV, the Private Fund Investment Advisors Registration Act of 2010, eliminates the "private adviser" exemption from SEC regulation. Accordingly, investment advisers to hedge funds, private equity funds, real estate funds, and certain other private funds with assets under management of $150 million or more, will be subject to SEC examination and will have to comply with SEC registration, record keeping, reporting and disclosure requirements. Venture capital fund advisers will not be subject to SEC registration requirements but will be required to maintain records and provide annual and other reports that the SEC may prescribe. Small business investment company advisers and "family offices" will also continue to be exempt from SEC registration.

State-regulated investment advisers with $100 million in assets under management are required to register with the SEC. State-regulated investment advisers with less than $100 million but at least $25 million in assets under management, and that would otherwise be required to register with 15 or more states, may register with the SEC.

Title IV also changes the definition of "Accredited Investor" by excluding the value of an individual's primary residence from the calculation of the $1 million threshold and by allowing the threshold to be adjusted for inflation.

Link to Text of Title IV

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## TITLE V - INSURANCE

### A. Office of National Insurance

Title V, the Federal Insurance Office Act of 2010, establishes a Federal Insurance Office (FIO) within the Treasury Department. The FIO has authority to monitor all aspects of the insurance industry, including identifying issues and gaps in the regulation of insurers that could contribute to a systemic financial crisis. The FIO, which has limited subpoena powers and preemption rights, is also charged with coordinating and consulting with federal and state regulators on matters ranging from terrorism and international insurance to affordable insurance products (except health insurance).

### B. State-Based Insurance Reform

The FIO Act does not provide for a national insurance charter or give the FIO authority to supervise or regulate insurance companies as state-based regulation of insurance companies is maintained. Subtitle B does, however, contain provisions intended to simplify the existing regulation of surplus lines insurance and reinsurance by limiting the number of states that may regulate certain transactions.

Link to Text of Title V

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### TITLE VI - IMPROVEMENTS TO REGULATION OF BANK AND SAVINGS ASSOCIATION HOLDING COMPANIES AND DEPOSITORY INSTITUTIONS

Title VI, the Bank and Savings Association Holding Companies and Depository Institutions Regulatory Improvements Act of 2010, includes what is commonly known as the "Volcker Rule." Under the Volker Rule provisions, banks, bank affiliates, and non-bank financial companies are prohibited from engaging in proprietary trading (trading for their own account)&#151subject to certain exceptions and a transition period. Banking entities are also prohibited from acquiring or retaining any equity, partnership, or other ownership interest in, or sponsoring, any hedge fund or private equity fund, again subject to limited exceptions and a transition period. Ownership in a hedge fund or private equity fund by a banking entity must be limited to 3% of total ownership interests of the fund. The total aggregate of all of a banking entity's interests in hedge funds and private equity funds may not exceed 3% of Tier 1 capital.

A three-year moratorium is placed on the FDIC approving applications for federal deposit insurance for entities owned by a "commercial firm"&#151that is, credit card banks, trust banks, and industrial banks. Likewise, during the same time period, any bank regulatory agency may not approve changes in control that will result in a "commercial firm" acquiring any of the same entities.

Title VI also contains provisions that require bank holding companies to serve as "sources of financial strength" for their depository institution subsidiaries and a provision that eliminates the long-standing prohibition against paying interest on demand deposits.

Link to Text of Title VI

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### TITLE VII - WALL STREET TRANSPARENCY AND ACCOUNTABILITY

- **A. Regulation of Over-the-Counter Swap Markets**
  - **I. Regulatory Authority**
  - **II. Regulation of Swap Markets**
- **B. Regulation of Security-Based Swap Markets**

Title VII, the Wall Street Transparency and Accountability Act of 2010, provides for comprehensive regulation of the over-the-counter and security-based derivatives markets. The SEC has responsibility for security-based swaps and the Commodity Futures Trading Commission (CFTC) is responsible for other swaps and related products. Title VII also provides for new clearing, trading, and trade reporting requirements. Under this Title, new capital, margin, and conduct requirements will apply to "significant market participants" (clearing, trading and exchange entities), who will now be subject to SEC or CFTC registration. The trading of derivatives by mutual funds, end-users, broker-dealers, banks, and hedge funds will also change.

Under Section 716, federal assistance (that is, access to the discount window) for swap entities is prohibited, and swap activities are required to be conducted from a non-bank affiliate. These prohibitions and requirements will not become effective for two years. In distancing derivatives trading from banks and bank oversight, this provision contemplates that the CFTC and SEC will largely have oversight for these transactions.

Link to Text of Title VII

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### TITLE VIII - PAYMENT, CLEARING, AND SETTLEMENT SUPERVISION

Under Title VIII, the Financial Stability Oversight Council is responsible for designating those financial market institutions whose payment, clearing, or settlement activities are, or are likely to become, systemically important. The Fed then has the power to prescribe risk management standards for these activities. Also included in this Title are provisions for emergency financial support for such activities and enhanced examination and enforcement over these institutions.

Link to Text of Title VIII

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## TITLE IX - INVESTOR PROTECTIONS AND IMPROVEMENTS TO THE REGULATION OF SECURITIES

### A. Increasing Investor Protection

Subtitle A provides for the establishment of an Office of Investor Advocate, an Investor Advisory Committee, and various studies regarding the obligations of brokers, dealers, and investment advisers, as well as the financial literacy of investors. Subject to the outcome of an SEC study, broker-dealers may soon be subject to fiduciary duties when giving personalized investment advice to retail clients.

### B. Increasing Regulatory Enforcement and Remedies

Subtitle B confers enhanced powers on the SEC, including the ability to seek civil monetary penalties in administrative actions, an expanded whistleblower award program, nationwide subpoena powers, and additional powers to bring aiding and abetting charges under federal law. The SEC is also granted the authority to prohibit, limit, or reaffirm mandatory pre-dispute arbitration agreements in investor contracts.

### C. Improvements to the Regulation of Credit Rating Agencies

Under Subtitle C, the SEC is given enhanced powers to monitor and control the activities of credit rating agencies. Subtitle C contains provisions addressing conflicts of interests that could harm investors, requiring transparency of rating procedures and methodologies, providing investors with a private right of action and providing the SEC with greater enforcement and examination tools regarding Nationally Recognized Statistical Rating Organizations (NRSROs).

### D. Improvements to the Asset-Backed Securitization Process

Subtitle D directs the federal banking agencies, the SEC, and HUD to issue regulations, within 270 days of enactment, requiring securitizers or originators to retain an economic interest in a portion of the credit risk of any securitized asset&#151including residential mortgage securitizations. Among other things, these regulations will prohibit direct and indirect hedging or transfer of the credit risk that is required to be retained. In most situations, a securitizer will be required to retain a minimum of 5% of the credit risk. With commercial mortgages the risk retention requirement may be satisfied by retention of a first loss position by a third-party purchaser who meets the standards to be imposed by the federal banking agencies and the SEC. An important carve-out for mortgage lending purposes is that of "qualified residential mortgages"&#151a term to be defined by future regulations&#151but one that will take into consideration underwriting and product features that historically have loan performance data indicating a lower risk of default. Mandatory arbitration for residential mortgages is also prohibited. This prohibition extends to open-end consumer credit secured by principal dwellings (such as home equity lines of credit) but does not apply to reverse mortgages.

### E. Municipal Securities

Title IX establishes the Office of Municipal Securities within the SEC to administer the SEC's rules with regard to municipal securities dealers, advisors, investors and issuers. Title IX also expands the rulemaking authority of the Municipal Securities Rulemaking Board (MSRB) and grants the MSRB authority over municipal advisors that solicit or provide advice to issuers of municipal securities or "obligated persons" with respect to the issuance of municipal securities, derivatives on municipal securities, or investment of proceeds of municipal offerings.

### F. Accountability and Executive Compensation

New laws and regulations will affect all public companies by modifying the regulation of corporate governance, executive compensation, and related disclosure obligations. The changes include non-binding shareholder votes on executive compensation ("say-on-pay"), compensation committee independence, compensation consultant and other advisor independence, disclosure of executive compensation compared to performance and median employee pay, and the development and implementation&#151by listed national stock exchange companies&#151of executive officer compensation clawback policies.

Publicly traded companies with a market capitalization of less than $75 million are exempted from undergoing an audit of internal controls under Section 404(b) of the Sarbanes-Oxley Act of 2002.

Link to Text of Title IX

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### TITLE X - BUREAU OF CONSUMER FINANCIAL PROTECTION (BCFP)

A. **Bureau of Consumer Financial Protection**
B. **General Powers of the Bureau**
C. **Specific Bureau Authorities**
D. **Preservation of State Law**
E. **Enforcement Powers**
F. **Transfer of Functions and Personnel; Transitional Provisions**
G. **Regulatory Improvements**
H. **Conforming Amendments**

Under Title X, the Bureau of Consumer Financial Protection (BCFP) is established and given unprecedented federal regulatory authority over consumer financial products and services and the enforcement of federal consumer financial laws.

BCFP will have exclusive rulemaking and examination, and primary enforcement authority, over all banks with over $10 billion in assets. For banks with less than $10 billion in assets, BCFP may require the filing of reports regarding their compliance with the federal consumer financial laws.

With respect to federal consumer financial laws, BCFP will have regulatory authority over many nondepository institutions and entities engaged in providing consumer financial products and services, including all mortgage-related businesses (lenders, services, mortgage brokers, and foreclosure scam operations), payday lenders, and student lenders, as well as others such as debt collectors and consumer reporting agencies.

All persons deemed "covered persons" may be required to register and file reports with the BCFP and will be subject to examination under "risk-based" supervision programs. Several exclusion categories do exist for "covered persons," including attorneys, tax preparers, accountants, most licensed real estate brokers and agents, most auto dealers, as well as others.

Existing preemption rules articulated by the OCC have been curtailed to conform to Barnett Bank of Marion County, N.A. v. Nelson (S. Ct.). In addition to scaling back federal preemption of state banking laws, the Act also expands state regulatory and enforcement powers. The powers of state attorneys general and state regulators have been expanded in a legislative reversal of the Supreme Court's holding in Watters v. Wachovia, and consistent with the Supreme Court's holding in Cuomo v. Clearing House Ass'n.

Link to Text of Title X

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### TITLE XI - FEDERAL RESERVE SYSTEM PROVISIONS

The Fed is directed to establish procedures and policies that will limit its emergency lending authority, particularly to prohibit the bailing out of any individual company. Provisions are included, however, for limited emergency financial stabilization programs during times of severe economic distress.

Link to Text of Title XI

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### TITLE XII - IMPROVING ACCESS TO MAINSTREAM FINANCIAL INSTITUTIONS

Title XII provides incentives to encourage greater participation in the financial system by low-and-medium income consumers. These incentives include small loan ("micro finance") programs and involve a variety of community and tax-exempt groups.

Link to Text of Title XII

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## TITLE XIII - PAY IT BACK ACT

This Title amends the Emergency Economic Stabilization Act of 2008 ("EESA") to reduce TARP funding and preclude any new TARP-like programs from being established.

Under this Title, unused funds under the American Recovery and Reinvestment Act of 2009, and all proceeds from the sale of Federal Home Loan Bank, Freddie, and Fannie debt purchased under the Treasury's emergency authority, are required to be used solely for deficit reduction.

Link to Text of Title XIII

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## TITLE XIV - MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT

Title XIV contains the latest set of residential mortgage loan law reforms since the mortgage meltdown in 2007.

### A. Residential Mortgage Loan Origination Standards

Under Subtitle A, residential mortgage loan origination standards establish new prohibitions relating to the compensation of "mortgage originators." Mortgage loan originators may not receive compensation that varies based on any term of the mortgage loan other than the principal amount of the loan. This prohibition effectively prohibits yield spread premiums and all compensation that varies based upon the interest rate and other financial terms of a mortgage loan.

### B. Minimum Standards for Mortgages

Under Subtitle B, creditors are prohibited from making mortgage loans without first making a good faith determination that the consumer has the ability to repay the loan. T is, however, a safe harbor rebuttable presumption for "qualified mortgages." "Qualified" mortgage loans are loans w among other things, the consumer's income, credit history, and other underwriting information are properly documented, and verified, and the fees payable in connection with the loan do not exceed 3% of the loan amount. Subtitle B also prohibits prepayment penalties for all loans that are not qualified loans and restricts prepayment penalties on qualified loans.

A foreclosure defense on the grounds of excessive fees or abusive terms, or for a violation of the "ability to pay" standard, may be raised by a borrower against a lender without regard to any statute of limitations.

### C. High-Cost Mortgages

Subtitle C amends the definition of "high-cost mortgages," changes certain existing requirements for high-cost mortgages, and adds new restrictions on high-cost mortgages, including limitations on late fees.

### D. Office of Housing Counseling

Subtitle D establishes the Office of Housing Counseling within HUD and provides for the monitoring administration of counseling procedures for home ownership and rental counseling.

### E. Mortgage Servicing

Subtitle E amends the Truth-in-Lending Act to require lenders to establish escrow accounts for taxes and insurance for, among other loans, federally insured or guaranteed loans, or conventional or jumbo loans that exceed an interest rate threshold. The Act also provides that the escrow accounts must be maintained for a minimum of five years, subject to certain exceptions. If such an account is not established, or one is closed by the borrower, the servicer must provide timely and clearly written disclosure to the borrower advising them of the implications to, and the responsibilities of, the borrower if such account does not exist.

### F. Appraisal Activities

Subtitle F imposes new property appraisal requirements and appraisal independent requirements. In that regard, a creditor is prohibited from making a high-risk mortgage without first obtaining a written appraisal of the subject property to include a physical property visit and interior inspection.

Link to Text of Title XIV

## CONCLUDING COMMENT

The Act, officially Public Law 111-203 and also referred to as H.R. 4173, contains hundreds of provisions designed to improve the U.S. financial system. While these provisions have sweeping implications for financial institutions and the U.S. economy, only time will tell if this landmark law will achieve its principal stated purpose of promoting the financial stability of the United States. Meanwhile, financial service providers, their customers, and all of those who work with providers or consumers of financial services and products will need to adapt to the changing financial services landscape. In that regard, it is hoped that the financial stability sought by the Act will foster economic growth and that the proliferation of new rules, regulations, and changes in regulatory bodies and process will not have the opposite effect.

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