Congress Finalizes Landmark Financial Regulatory Reform Legislation

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act, HR4173/Public Law 111-203, the most sweeping overhaul of the US financial sector since the Great Depression. The Act will affect the manner in which financial services companies are regulated, supervised, and in some cases structured. As a result of the Act, providers of financial services are likely to face increased compliance expectations and costs, and depository institutions and their holding companies will likely face stricter capital requirements and prudential standards, creating additional profitability and funding challenges.

The legislation will also affect companies outside of the financial services industry. For example, every public company will be affected by Title IX of the Act's executive compensation and corporate governance reforms. Title I of the Act's creation of a new systemic risk council to monitor macroeconomic threats to US financial stability will result in heightened supervision of entities and activities presenting such risks. Counterparties to systemically important entities will wish to take note of the new resolution process created by Title II in order to minimize potential loss in a liquidation context. Companies that trade or use derivatives are potentially affected by the new rules in Title VII, such as the significant new restrictions on certain proprietary trading activities, derivatives activities, and hedge fund and private equity fund activities, to name a few. Under Title IV, advisers to most hedge funds and private equity funds will be required to register with the SEC as investment advisers due to elimination of the "private adviser" exemption. Companies offering consumer financial products and services may be subject to the consumer financial protection changes made by Title X, including its new regulatory bureau. Residential real estate providers will face new regulatory requirements created by Title XIV. These changes are both significant and far-reaching.

This advisory provides a high level, title-by-title overview of the Act. Arnold & Porter LLP is issuing a series of advisories that will provide more detailed analyses on the major topics covered by the Act.

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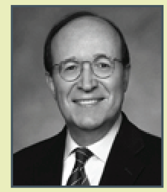

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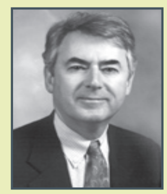

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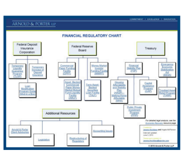

Financial Regulatory Chart

Financial Regulatory Reform: *For Arnold & Porter's latest resources on this topic including Advisories, upcoming events, and publications, please visit Financial Regulatory Reform. Also visit our Financial Regulatory Chart, which aggregates information on US government programs.*

Title I. Financial Stability

Authority of the FSOC. Title I of the Act creates a Financial Stability Oversight Council (FSOC) to address systemic risk in the financial system, effective upon the Act's enactment. The FSOC will be comprised of 10 voting members and 5 non-voting members, and will include the Secretary of the United States Treasury (Treasury Secretary), representatives of each of the federal financial regulators, and others.[1]

The FSOC has the authority to subject certain US or foreign nonbank financial companies that it believes would pose a threat to the financial stability of the United States to the supervision of the Board of Governors of the Federal Reserve System (Federal Reserve), as well as certain large bank holding companies, to more stringent regulation by the Federal Reserve. It also may subject such "systemically significant" nonbank financial companies and large bank holding companies to stricter operating standards, including higher capital requirements, leverage limits, liquidity requirements, concentration limits, resolution plan and credit exposure requirements, enhanced public disclosures, short-term debt limits, and overall risk management requirements. The standards would not apply to any bank holding company with total consolidated assets of less than $50 billion. While there is no such floor for nonbank financial companies, only the largest such companies likely would be covered.

Title I defines "nonbank financial companies" as those companies, other than bank holding companies or their subsidiaries with either (i) revenues from activities that are financial in nature that comprise at least 85 percent of the consolidated annual gross revenues of the company; or (ii) consolidated assets that are financial in nature that comprise at least 85 percent of the consolidated assets of the company. Activities that are "financial in nature" are those listed in section 4(k) of the Bank Holding Company Act of 1956, as amended—primarily banking, insurance, securities, and passive merchant banking activities.

Additional Standards for Certain Activities or Practices. The FSOC also may make recommendations to the primary financial regulatory agencies (defined as the federal banking, securities, commodities, and housing regulators, and state insurance commissioners) to apply stricter standards to a "financial activity or practice conducted by bank holding companies or nonbank financial companies under their respective jurisdictions." Such a recommendation could be made if the FSOC determines that the conduct of the activity or practice in question could create or increase the risk of significant liquidity, credit, or other problems spreading among bank holding companies and nonbank financial companies; the financial markets of the United States; or low-income, minority, or underserved communities. A primary financial regulatory agency must impose the standards recommended by the FSOC or similar standards that the FSOC deems acceptable, or explain its reasons for not following the recommendation.

The Act also gives the Federal Reserve, in consultation with the FSOC, the power to terminate or impose conditions on one or more activities of a nonbank financial company determined to be subject to supervision by the Federal Reserve or a bank holding company with consolidated assets greater than or equal to $50 billion, or force such company to sell assets, if necessary to mitigate a "grave" threat to the financial stability of the United States posed by that company if less extreme actions are inadequate to mitigate the threat.

Stress Tests. Title I also requires the Federal Reserve, in coordination with the appropriate primary financial regulatory agency, to conduct annual stress tests on each nonbank financial company determined to be subject to supervision by the Federal Reserve and each bank holding company with total consolidated assets equal to or greater than $50

1 The voting members are:
- The Treasury Secretary;
- The Chairman of the Board of Governors of the Federal Reserve System;
- The Comptroller of the Currency;
- The Director of the newly created Bureau of Consumer Financial Protection;
- The Chairman of the Securities and Exchange Commission;
- The Chairman of the Federal Deposit Insurance Corporation;
- The Chairman of the Commodity Futures Trading Commission;
- The Director of the Federal Housing Finance Agency;
- The Chairman of the National Credit Union Administration Board; and
- An independent member appointed by the President, in consultation with the Senate, having insurance expertise.

The nonvoting members will include the Director of the newly created Office of Financial Research, the Director of the newly created Federal Insurance Office, a state insurance commissioner, a state banking supervisor, and a state securities commissioner.

billion to determine if the company has the capital, on a total consolidated basis, necessary to absorb losses as a result of adverse economic conditions. Each of these companies also must conduct its own stress tests semi-annually. All other financial companies with consolidated assets of at least $10 billion that are regulated by a primary federal financial regulatory agency must conduct annual stress tests. The methodology for these self-stress tests will be determined by regulations issued by each primary federal financial regulatory agency, in coordination with the Federal Reserve and the Federal Insurance Office.

Risk Committee. The Federal Reserve is required to issue regulations requiring systemically significant nonbank financial companies supervised by it and bank holding companies that are publicly traded and have total consolidated assets of $10 billion or more to establish a risk committee to oversee the entity's enterprise-wide risk management practices. Bank holding companies that are publicly traded and have total consolidated assets of less than $10 billion may also need to establish such a risk committee upon Federal Reserve direction, but it is not automatically required. The risk committee is to be responsible for the oversight of the enterprise-wide risk management practices of the company, and may include independent directors if the Federal Reserve determines it is appropriate, based on the nature of operations, size of assets, or other criteria related to the company. In addition, the committee will be required to have at least one member who has experience in identifying, assessing, and managing risk exposures of large complex firms.

Segregation of Activities. The Federal Reserve also is given the authority to require systemically significant nonbank financial companies subject to its supervision that engage in some activities that are not deemed to be financial in nature to create an intermediate holding company to house those of its activities that are financial in nature as defined in section 4(k) of the Bank Holding Company Act. That intermediate holding company then would become the nonbank financial company supervised by the Federal Reserve. In forming an intermediate holding company, internal financial activities conducted by the company do not need to be moved to the intermediate holding company. Title I is very specific that a nonbank financial company supervised by the Federal Reserve, or a company that controls a nonbank financial company supervised by the Federal Reserve, is *not* required to conform its activities to those financial activities listed in section 4(k) of the Bank Holding Company Act.

"Hotel California" Provision. Title I also contains a provision that has come to be known as the "Hotel California" provision, which provides that if a bank holding company had total consolidated assets equal to or greater than $50 billion as of January 1, 2010, and received financial assistance under or participated in the Capital Purchase Program established under the Troubled Asset Relief Program authorized by the Emergency Economic Stabilization Act of 2008, then it will be treated as a nonbank financial company subject to supervision by the Federal Reserve if it ceases to be a bank holding company. A company subject to the Hotel California Provision may request a hearing before the FSOC to appeal its treatment as a nonbank financial company supervised by the Federal Reserve.

Collins Amendment. Title I also contains a revised version of the Collins Amendment, which requires the federal banking agencies to establish minimum leverage and risk-based capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies (bank holding companies and savings and loan holding companies), and nonbank financial companies supervised by the Federal Reserve. This will be the first time that savings and loan holding companies will be specifically *required* by statute to comply with consolidated capital requirements.[2]

As a result of the Collins Amendment, trust-preferred securities, which are a type of hybrid capital that has qualified for Tier 1 Capital, will no longer be eligible for such Tier 1 capital treatment going forward for large and medium-sized depository institution holding companies. Upon enactment, the requirement to exclude hybrid capital instruments such as trust-preferred securities from Tier 1 capital becomes

2 In addition, in section 616(d) of the Act, the Federal Deposit Insurance Act is amended to require the appropriate federal banking agency for a bank holding company or savings and loan company, or insured depository institution not a subsidiary of a bank holding company or savings and loan holding company (e.g., an industrial bank) to require that such bank holding company, savings and loan holding company or parent company of an insured depository institution act as a source of strength to its insured depository institution subsidiary.

immediately effective for hybrid capital instruments issued on or after May 19, 2010, by depository institution holding companies (except small bank holding companies with less than $500 million in assets) and nonbank financial companies supervised by the Federal Reserve. For hybrid capital instruments issued before May 19, 2010, by depository institution holding companies with total consolidated assets of $15 billion or more and nonbank financial companies supervised by the Federal Reserve, the requirement to exclude pre-May 19, 2010-issued hybrid capital instruments from Tier 1 capital will be phased in incrementally over a period of three years, beginning January 1, 2013. For hybrid capital instruments issued before May 19, 2010, by depository institution companies with total consolidated assets of less than $15 billion as of December 31, 2009, and by companies that were mutual holding companies on May 19, 2010, there is no requirement to deduct pre-May 19, 2010-issued hybrid capital instruments from Tier 1 capital.

Small bank holding companies with less than $500 million in assets will continue to be subject to the Federal Reserve's Small Bank Holding Company Policy Statement and will not be subject to the risk-based and leverage capital requirements (or the exclusion for certain hybrid instruments from Tier 1 capital) under the Collins Amendment.

In addition, the requirement to exclude hybrid capital instruments from Tier 1 capital becomes immediately effective upon enactment of the Act for hybrid capital instruments issued on or after May 19, 2010, by US bank holding company subsidiaries of foreign banking organizations that have relied on the Federal Reserve's Supervision and Regulation Letter SR–01–1 (SR–01–1 Exemption), which relates to compliance with capital adequacy standards by certain US bank holding companies owned by foreign banks that the Federal Reserve has determined are well-capitalized and well-managed. The other risk-based and leverage capital requirements (including the deduction for certain pre-May 19, 2010-issued hybrid capital instruments from Tier 1 capital) under the Collins Amendment will become effective for such entities five years after the enactment of the Act. Depository institution holding companies not previously supervised by the Federal Reserve (e.g., savings and loan holding companies) also will have a five-year grace period for the leverage and risk-based capital requirements of the Collins Amendment other than those relating to the treatment of the deduction of hybrid capital instruments from Tier 1 capital, whether issued before or after May 19, 2010.

Additionally, subject to the recommendations of the Council, the Act requires that the federal banking agencies develop capital requirements applicable to insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Federal Reserve that address the risks that the activities of such institutions pose to the institution engaging in the activity and other public and private stakeholders, in the event of adverse performance, disruption, or failure of the institution or the activity. At a minimum, the capital requirements must address the risks arising from:

- Significant volumes of activity in derivatives, securitized products, financial guarantees, securities borrowing and lending, and repurchase and reverse repurchase agreements;
- Concentrations in assets for which the values presented in financial reports are based on models rather than historical cost or prices deriving from deep and liquid two-way markets; and
- Concentrations in market share for any activity that would substantially disrupt financial markets if the institution is unexpectedly forced to cease the activity.

Title II. Orderly Liquidation Authority

To prevent future taxpayer bailouts of firms deemed "too big to fail," Title II of the Act gives the Federal Deposit Insurance Corporation (FDIC) power to unwind large failing bank holding companies and other nonbank financial companies determined to be subject to supervision by the Federal Reserve. While the Bankruptcy Code and the FDIC resolution process would continue to apply to most failing financial companies, the orderly liquidation authority established by the Act would apply when failure of a financial company would threaten the stability of the entire US financial system.

In light of its exceptional nature, liquidation of a company under Title II of the Act must be approved by the Federal Reserve, the FDIC, and the Treasury Secretary (in consultation with the President). If the failing company does not consent to the appointment of the FDIC as receiver, the Treasury Secretary must petition the District Court for the District of Columbia for an order authorizing the appointment. The District Court's determination is reviewable by the Court of Appeals for the DC Circuit, whose decision is in turn subject to discretionary review by the US Supreme Court.

Liquidation pursuant to Title II must comply with several mandatory terms:

- The FDIC must ensure that shareholders do not receive any payment until after all other claims are fully paid, that unsecured creditors bear losses in accordance with the Title's priority provisions, and that managers responsible for the company's failure are removed.
- The FDIC may also hold directors and officers of companies placed into receivership personally liable for damages arising from gross negligence and may recover compensation previously paid to senior executives and directors "substantially responsible" for the failure of the company.

The Act explicitly prohibits the use of taxpayer funds to rescue a failing financial firm placed into receivership. Instead, the costs of unwinding a firm would be paid with proceeds from its liquidation and an after-the-fact assessment on financial companies with at least $50 billion in total consolidated assets and on any nonbank financial companies supervised by the Federal Reserve.

Title III. Transfer of Powers to the OCC, FDIC, and Federal Reserve

Title III of the Act abolishes the Office of Thrift Supervision (OTS) and allocates its responsibilities, personnel, and assets among the Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the FDIC. The Federal Reserve assumes responsibility for supervision of savings and loan holding companies and their nonbank subsidiaries, while federal savings associations and state savings associations become the responsibility of the OCC and the FDIC, respectively. Prospectively, OTS rulemaking authority is divided between the Federal Reserve and the OCC, and the new position of "Deputy Comptroller for the Supervision and Examination of Federal Savings Associations" is created at the OCC. Existing OTS regulations, orders, legal actions, guidance, and similar materials remain in force until altered or otherwise acted on by the Federal Reserve, the OCC, or the FDIC. These changes generally become effective one year from enactment of the legislation, which may be extended by the Treasury Secretary for up to six additional months (Transfer Date). The abolition of the OTS would become effective 90 days after the Transfer Date. The Director of the newly created Consumer Financial Protection Bureau would then replace the Director of the OTS on the FDIC Board of Directors.

The Act leaves intact the federal thrift charter and does not mandate the conversion of existing federal thrift charters to bank charters. However, it does facilitate such conversions by allowing a converted savings association to retain any branches it operated at the time of conversion, notwithstanding state or federal law to the contrary, and to establish additional branches in any state in which it operated a branch at the time of its conversion as if it were a bank chartered in that state.

The Act also makes important changes to the federal deposit insurance program. The temporary increase of the federal deposit insurance limit to $250,000, currently set to expire at the end of 2013, is made permanent and is retroactively applied to January 1, 2008. Additionally, noninterest-bearing transaction accounts remain fully insured through the end of 2012, at which point the program terminates. The Act also instructs the FDIC to amend the regulatory definition of "assessment base" to shift to an asset-based, rather than a liability-based, formula, and the FDIC is given authority to exclude an institution from eligibility for the lowest-risk assessment category based solely on the institution's size.

Title IV. Regulation of Advisers to Hedge Funds and Others

Title IV of the Act amends the Investment Advisers Act of 1940 (Advisers Act) to impose Securities and Exchange Commission (SEC) registration, reporting, and record-keeping obligations on investment advisers to "private funds" that have assets under management in the United States of $150 million or more, subject to limited exemptions. Advisers to such funds (which include hedge funds, private equity funds, and other private funds not subject to an exemption) will be subject to Advisers Act regulation through elimination of the "private adviser" exemption in the Advisers Act that applies to investment advisers who, during the course of the preceding 12 months, had fewer than 15 clients (with a fund counting as a single client) and who do not hold themselves out to the public as an investment adviser or act as an investment adviser to a registered investment company. Elimination of the "private adviser" exemption applies to investment advisers generally, not just those that act as advisers to private funds.

Exemptions. Although elimination of the "private adviser" exemption would subject advisers to virtually all private funds to Advisers Act registration, the Act carves out exemptions for:

- Investment advisers that act solely as an adviser to private funds with US assets under management of less than $150 million. These advisers will be subject to SEC record-keeping and reporting requirements;[3]
- Investment advisers who solely advise small business companies;
- "Foreign private advisers" (as defined in the Act);
- Investment advisers that act as advisers solely to "venture capital funds" (to be defined by SEC rule). These advisers will be subject to SEC record-keeping and reporting requirements; and
- Any "family office" (as defined by SEC rule, regulation, or order), effected through an amendment to the definition of "investment adviser."

Records and Reports. The SEC is authorized to require advisers to private funds to maintain records and file reports with the SEC.[4] The SEC may share this information with the FSOC, which may use it to determine whether to designate a private investment fund as "systemically significant" and therefore subject to Federal Reserve supervision, capital requirements, risk controls, pre-packaged liquidation plan requirements, the FDIC's orderly liquidation authority, and other significant and pervasive regulatory requirements that will apply to financial companies so designated under Titles I and II of the Act.[5]

Custody Requirement. Registered investment advisers are required to take such steps to safeguard client assets over which the adviser has custody, including verification of such assets by an independent public accountant, as the SEC may prescribe by rule.[6]

Accredited Investors. The Act directs that changes be made to adjust the net-worth standard required to qualify as an "accredited investor" under the Securities Act of 1933, principally by excluding the value of a primary residence from the calculation.

Effective Date. The effective date for the private fund provisions is generally one year after the date of enactment of the Act. An investment adviser to a private fund is permitted to register under the Advisers Act during the one-year transition period, subject to SEC rules.

Title V. Insurance

Title V of the Act establishes the Federal Insurance Office (FIO) within the Department of the Treasury. Once established, the FIO will be responsible for comprehensive monitoring of the insurance industry (other than health insurance, certain long-term care insurance, and crop insurance). The FIO will be

3 Investment advisers with clients other than private funds that have less than $25 million in assets under management (or such higher amount as the SEC specifies by rule) continue to be subject to state law and are not permitted to register with the SEC. An investment adviser that has assets under management between $25 million and $100 million that is required to register as an investment adviser in the state where the adviser maintains its principal office and place of business and is subject to examination in that state must generally register under state law rather than with the SEC. However, if the effect of this provision would be to require that the investment adviser register with 15 or more states, then the adviser is permitted to register with the SEC. In addition, as has previously been the case, SEC registration is required if the adviser acts as an investment adviser to an investment company registered under the Investment Company Act or to a business development company.

4 Records and reports to be maintained by an investment adviser include the amount of assets under management; use of leverage, including off-balance sheet leverage; counterparty credit risk exposure; trading and investment positions; valuation policies and practices; types of assets held; side arrangements or side letters, whereby certain fund investors obtain more favorable rights than others; trading practices; and other information that the SEC, in consultation with the FSOC, determines is necessary or appropriate in the public interest or for the assessment of systemic risk.

5 The FSOC and any department, agency, or self-regulatory organization that receives records or other information of private funds from the SEC must keep it confidential. The Act provides enhanced protection for "proprietary information" of a private fund adviser. This information is subject to the same limitations on public disclosure as any facts ascertained during an investment adviser examination under Section 210(b) of the Advisers Act.

6 The SEC recently adopted new rules that provide additional safeguards when a registered adviser has custody of client funds or securities.

able to recommend to the FSOC that it designate an insurer, including its affiliates, as an entity subject to regulation by the Federal Reserve as a nonbank financial company. The Act does not specify a timeframe for the Treasury Secretary to issue regulations to establish the FIO.

The FIO also will coordinate federal efforts and establish federal policy on prudential aspects of international insurance matters, determine whether state insurance measures are preempted by certain international insurance agreements, and consult with the states regarding insurance matters of national importance and prudential insurance matters of international importance. The new agency also is authorized to conduct a study and submit a report to Congress on how to modernize and improve the system of insurance regulation in the United States. The Act also authorizes the Treasury Secretary and the United States Trade Representative, jointly, to negotiate and enter into international insurance agreements regarding prudential measures on behalf of the United States. The FIO may require an insurer or an affiliate to submit information reasonably required to carry out these functions, working in cooperation with the appropriate state regulatory agencies.

The Act also includes some protections for companies offering reinsurance by prohibiting non-domiciliary states from denying credit for reinsurance if the state of domicile of a ceding insurer (the insurance company that buys the reinsurance) is a state accredited by the National Association of Insurance Commissioners or has solvency requirements substantially similar to those required for accreditation. Furthermore, the Act provides that in such a case the state of domicile of the reinsurer is solely responsible for regulating the financial solvency of the reinsurer.

Title VI. Improvements to Regulation of Bank and Savings Association Holding Companies and Depository Institutions

Title VI of the Act contains several new provisions affecting the regulation of insured depository institutions and their holding companies.

Moratorium for Certain Deposit Insurance Applications. For example, Title VI imposes a three-year moratorium on the ability of the FDIC to approve a new application for deposit insurance for an industrial loan company, credit card bank, or trust bank that is owned or controlled by a commercial firm (an entity that derives at least 15 percent of its consolidated annual gross revenues, including all affiliates, from non-financial activities). During this period, the appropriate federal banking agency may not approve a change in control of an industrial loan company, a credit card bank, or a trust bank if the change in control would result in direct or indirect control of that bank by a commercial firm, unless the bank is in danger of default, or unless the change in control results from certain *bona fide* merger or acquisition transactions. The Act further provides that the Comptroller General must submit a report to Congress analyzing whether it is necessary to eliminate the exceptions in the Bank Holding Company Act for credit card banks, industrial loan companies, trust banks, thrifts, and certain other entities in order to strengthen the safety and soundness of these institutions or the stability of the financial system.

Enhanced Regulation of Holding Company Entities. In order to aid a consolidated supervisor's ability to identify and address risk throughout an organization, the Act also removes limitations under the Gramm-Leach-Bliley Act on the ability of a federal banking agency to obtain reports from, examine, and regulate all subsidiaries of a bank or savings and loan holding company it supervises. The Act also provides that the lead federal banking agency for each depository institution holding company (which would be the Federal Reserve or the OTS prior to the Transfer Date and would be the Federal Reserve in all cases after the Transfer Date) must examine the permissible activities of each non-depository institution subsidiary, other than a functionally regulated subsidiary, of that holding company to determine whether those activities present safety and soundness risks to any depository institution subsidiary. Thus, any affiliate of a depository institution would be made subject to the same standards and examined with the same frequency as the depository institution itself within the same holding company structure. This approach is intended to ensure that the placement of an activity in a holding company structure could not be used to arbitrage between different supervisory regimes or approaches.

Volcker Rule. Title VI also contains the so-called "Volcker Rule." Under these provisions, subject to certain exemptions, federal regulators must issue regulations to prohibit "banking entities" (i.e., insured depository institutions, their holding companies, non-US banks with branches or agency offices in the US, and any affiliate or subsidiary of such entities) from engaging in proprietary trading,[7] sponsoring or investing in hedge funds and private equity funds, and having certain financial relationships with those hedge funds or private equity funds for which they serve as investment manager or investment adviser. A systemically significant non-bank financial company supervised by the Federal Reserve that engages in such activities would be subject to rules establishing enhanced capital standards and quantitative limits, but such activities would not be prohibited.

Subject to restrictions that the appropriate federal banking agencies, the SEC, and the Commodity Futures Trading Commission (CFTC) may determine, certain activities would not be subject to these limitations, including:

- The purchase, sale, acquisition, or disposition of obligations of the United States, Ginnie Mae, Fannie Mae, Freddie Mac, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation, or a Farm Credit System institution; and state or municipal obligations.
- Transactions in connection with underwriting or market-making-related activities, to the extent that any such activities are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.
- Hedging activities designed to mitigate risks associated with individual or aggregated positions.
- Transactions on behalf of customers.
- Investments in small business investment companies; investments designed primarily to promote the public welfare; or investments that are qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure.
- The purchase, sale, acquisition, or disposition of securities and other instruments by a regulated insurance company for the general account of the company and by any affiliate of such regulated insurance company, subject to certain requirements.
- Organizing and offering a private equity or hedge fund, including serving as a general partner, managing member, or trustee of the fund and selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the directors, trustees, or management of the fund, provided certain requirements set forth in the law are met. These requirements include that the banking entity provide *bona fide* trust, fiduciary, or investment advisory services; that the fund be organized and offered only in connection with the provision of such services and only to persons that are customers of such services of the banking entity; and that the banking entity not acquire or retain more than a specified *de minimis* ownership interest in the fund.
- Proprietary trading conducted solely outside of the United States by a banking entity pursuant to Section 4(c)(9) or 4(c)(13) of the Bank Holding Company Act, unless the entity is controlled by a banking entity organized in the United States.
- The acquisition or retention of any equity, partnership, or other ownership interest in, or the sponsorship of, a hedge fund or a private equity fund by a banking entity pursuant to Section 4(c)(9) or 4(c)(13) of the Bank Holding Company Act solely outside of the United States, provided that no ownership interest in such hedge fund or private equity fund is offered or sold to United States residents and the banking entity is not controlled by a banking entity organized in the United States.
- Other activity as permitted by regulators.

These permitted activities may be prohibited if the transaction, class of transactions, or activity:

7 "Proprietary trading," for purposes of the Volcker Rule, means engaging as a principal for an entity's "trading account" in purchases or sales of securities, derivatives, commodity futures, options on such instruments, and any other financial instrument that the appropriate federal banking agencies, the SEC, and the CFTC may, by rule, determine. "Trading account," for purposes of the Volcker Rule, means any account used to take positions principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements), and such other accounts as the regulators may determine.

- Would involve or result in a material conflict of interest (as defined by regulators) between the banking entity and its clients, customers, or counterparties;
- Would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies (as defined by regulators); or
- Would pose a threat to the safety and soundness of such banking entity or to the financial stability of the United States.

The Volcker Rule will not become effective until the earlier of one year after the issuance of final rules implementing it, or two years after the date of enactment of the Act. In addition, there is a two-year transition period, with up to three one-year extensions available for banking entities and systemically important nonbank financial companies to come into compliance. In addition, an extension may be granted, upon application, for up to a maximum of five years for a banking entity's contractual obligation with any equity or other ownership interest in certain illiquid funds.

Concentration Limits and Other Restrictions. The Act also imposes concentration limits on large financial companies, including nonbank financial companies supervised by the Federal Reserve and foreign banks or companies that are treated as bank holding companies, with the result that these financial companies would not be permitted to merge with, or otherwise acquire control of, another company if the total US consolidated liabilities of the acquiring company upon consummation of the transaction would exceed 10 percent of the aggregate US consolidated liabilities of all financial companies at the end of the calendar year preceding the transaction.

The Act also would, among other things:

- Expand existing restrictions on bank transactions with affiliates by adding credit exposure from a securities borrowing or lending transaction or derivative transaction to the list of inter-affiliate "covered transactions" in Section 23A of the Federal Reserve Act, and by defining an investment fund for which a member bank is an investment adviser as an affiliate of the member bank under Section 23A;
- Expand the type of transactions subject to insider lending limits to include derivatives transactions, repurchase agreements, reverse repurchase agreements, and securities lending or borrowing transactions;
- Tighten national bank lending limits by treating credit exposures on derivatives, repurchase agreements, reverse repurchase agreements, and securities lending or borrowing transactions as extensions of credit for purposes of national bank lending limits; and
- Require that insured state banks may engage in derivatives transactions (as defined under national bank lending limits laws) only if the law with respect to lending limits of the state in which the insured state bank is chartered takes into consideration credit exposure to derivative transactions.

Source of Strength Doctrine. The Act codifies the source of strength doctrine by amending the Federal Deposit Insurance Act to state that the appropriate federal banking agency for a bank holding company or savings and loan holding company must require the bank holding company or savings and loan holding company to serve as a source of financial strength for its depository institution subsidiaries. If an insured depository institution is not the subsidiary of a bank holding company or savings and loan holding company, the appropriate federal banking agency for the insured depository institution must require any company that directly or indirectly controls the insured depository institution to serve as a source of financial strength for such institution. Notably, this will be the first time that savings and loan holding companies are required to serve as a source of strength for their depository institution subsidiaries. Previously, only bank holding companies were required to serve as a source of strength for their depository institution subsidiaries under Regulation Y, 12 C.F.R. § 225.4(a)(1).

Title VII. Wall Street Transparency and Accountability (Over-the-Counter Derivatives)

Title VII of the Act provides for unprecedented and substantial regulation of the over-the-counter derivatives market, including swaps. In an effort to provide additional "transparency" to financial markets, the Act increases the regulatory requirements imposed on various financial entities that utilize derivatives products. More specifically, the Act regulates "swap dealers" and "major swap participants," whose definitions would likely include banks, large hedge funds, and possibly even large insurance and some finance companies. Requirements imposed on entities that fit within the definition of swap dealers and major swap participants include registration requirements, posting of margin for trades, capital requirements, reporting and recordkeeping requirements, and business conduct standards. Certain "end-user" businesses could be exempt from many of the above requirements if their positions in derivatives are determined to be for hedging and commercial risk mitigation purposes.

Additionally, the Act amends the Commodity Exchange Act to implement mandatory clearing of swaps on clearinghouses. In general, the CFTC is assigned the responsibilities of reviewing any swap that a clearinghouse lists for clearing and of determining whether the swap or class of swaps is required to be cleared. In a broadening of the exemption contemplated in earlier versions of the legislation, the final version of the Act generally exempts an entity from the clearing requirement if one of the counterparties to the swap is not a financial entity and is using the swap to hedge or mitigate commercial risk.

The Act also directs the CFTC to impose position limits on swaps if it determines that the swap has a "significant price discovery function." In determining a swap's "significant price discovery function," the CFTC will consider various criteria, including the swap's price linkage to traded contracts, the potential for price arbitrage between the swap and a contract on the traded platform, and whether such contracts are sufficiently liquid. As a compromise over one the most contentious issues in the legislation, the Act stops short of requiring banks to divest all of their swaps activities and instead permits them to maintain their derivatives business in products that are tied to hedging for the banks' own risk. Such products would likely include interest rate swaps, gold, and silver, as well as credit products. However, trades in agriculture products, energy swaps, and uncleared commodities would likely have to be spun off to the bank's affiliates, which would be required to meet significant capital requirements. Unlike many other sections of the Act which require implementation one year after enactment, the bank divesture provision is required to be implemented two years after implementation of the Act.

Title VIII. Payment, Clearing, and Settlement Supervision

Title VIII of the Act contains a number of provisions designed to mitigate systemic risk in the financial system by giving regulators an enhanced role in the supervision of "financial market utilities" (FMUs), such as clearinghouses and other financial institutions that participate in payment, clearing, or settlement activities. The Act authorizes the FSOC to designate an FMU or certain payment, clearing, and settlement activities carried out by a financial institution as "systemically important" based on criteria such as the aggregate value of processed transactions and the aggregate exposure of a financial institution to its counterparties.

The Act directs the Federal Reserve to issue uniform risk management standards governing systemically important payment, clearing, and settlement activities. The Federal Reserve is also authorized to allow a Federal Reserve bank to grant discount and borrowing privileges to a systemically important FMU in "unusual and exigent" circumstances. The Act grants examination and enforcement authority to an institution's primary federal regulator, while reserving emergency or back-up enforcement authority for the Federal Reserve. Rulemaking authority is granted to the Federal Reserve, the FSOC, and other supervisory agencies.

Title IX. Investor Protections and Improvements to the Regulation of Securities

Securitization Reforms

In order to address practices believed to have played a major role in the recent financial crisis, Title IX of the Act makes substantial changes to the processes by which asset-backed securities are created, rated, and sold. In order to promote responsible lending and securitization, the Act directs regulators to issue rules requiring lenders to retain credit risk for any asset transfer or sell, through the issuance of an asset-backed security. It also directs the SEC to adopt rules requiring disclosure of tranche-specific information as to the assets underlying such securities. Issuers of such securities are also required to conduct and disclose the results of a due diligence analysis of underlying assets.

Credit Rating Reforms

The Act reflects a compromise as to a method for addressing the conflicts raised by the traditional "issuer pays" model of securing credit ratings that had been proposed by Sen. Al Franken (D-Minn.). The Franken proposal would have created a Credit Rating Agency Board to assign rating agencies to provide initial ratings of asset-backed securities. The Act, however, requires the SEC to study conflicts of interest at rating agencies. If the SEC deems it necessary based on the study, it would be authorized to establish a system for the assignment of rating agencies to issue initial ratings for asset-backed securities such that the issuer, sponsor, or underwriter would not be able to select the rating agency.

The Act also removes references to Nationally Recognized Statistical Ratings Organizations and credit ratings from the Federal Deposit Insurance Act, the Investment Company Act, and the Exchange Act. In each of these statutes, the Act replaces references to investments that meet certain credit ratings with references to investments that meet standards of creditworthiness established by the agencies that oversee those statutes. Finally, the Act eases pleading standards in plaintiffs' actions against credit rating agencies and applies enforcement and penalty standards to statements by rating agencies to the same extent that they apply to statements by registered public accountants and securities analysts.

Regulation of Broker-Dealers and Investment Advisers

For broker-dealers, the legislation includes several items of particular note. The Act directs the SEC to conduct a study of how broker-dealers' and investment advisers' relationships with retail customers are regulated. The SEC must describe any gaps or overlap in the two systems in a report to Congress within six months of enactment. The Act gives the SEC authority to adopt rules for the standard of care for broker-dealers and advisers and directs the SEC to consider the study's findings. The SEC may adopt a "best interest" fiduciary duty standard for broker-dealers, investment advisers, and their associated persons when providing advice to retail customers.

On a more substantive basis, the Act extends the protections of the Securities Investor Protection Act by permitting both securities and related futures to be held in a single "portfolio margin account," thereby allowing investors to hedge more effectively. It also extends the authority of the Public Company Accounting Oversight Board to allow it to write professional standards, inspect audits, and bring disciplinary proceedings for deficiencies in audits of securities broker-dealers that are not issuers. Finally, it authorizes the SEC to issue rules to prohibit or restrict mandatory pre-dispute arbitration clauses in broker-dealer and investment adviser account agreements.

Whistleblowers, Accomplice Liability, Short Sale Disclosures, and Other Reforms

The Act also effects numerous other changes to the securities laws. For example, it:

- Codifies the SEC's whistleblower program and strengthens it by providing for substantial awards, the creation of a fund for such awards, and sanctions for retaliatory firings, including attorneys' fees and double the amount of lost income;
- Amends the Securities Act, Exchange Act, Investment Company Act, and Advisers Act so that in an SEC enforcement action, persons may be held liable for knowingly or recklessly providing substantial assistance to a violator;
- Strengthens oversight of municipal securities markets by requiring persons who advise municipalities on bond issuances, or who otherwise participate in or solicit issuances (including guaranteed investment contract brokers, swap advisors, and finders), to register with the SEC;
- Requires the SEC to issue rules to provide for public disclosure of aggregate short sale data for individual securities at least each month; and
- Requires broker-dealers to inform customers (i) that they may elect not to allow their fully paid securities to be used in connection with short sales; and (ii) that the broker may receive compensation if they are so used.

The Act directs numerous organizational changes within the SEC. Notably, it directs the SEC's Divisions of Trading and Markets and Investment Management to have their own examination staffs, streamlines and accelerates the process for rule changes by self-regulatory organizations, codifies the establishment of the SEC's Investor Advisory Committee, and creates an Investor Advocate's Office to assist and represent the interests of retail investors.

Executive Compensation and Governance Reforms

The Act includes governance and executive compensation provisions that will significantly affect public companies. The Act also prohibits covered financial institutions with $1 billion or more in assets from rewarding their executive officers, employees, directors, and principal shareholders with incentive-based compensation arrangements that encourage "inappropriate risks," and requires reporting of all incentive-based compensation arrangements to the appropriate federal regulator.

Proxy Access. The Act grants the SEC authority to issue rules permitting a shareholder access to a company's proxy solicitation materials for the purpose of nominating directors. Despite efforts to introduce language into the legislation limiting the right of shareholders to nominate directors in a company's proxy materials to those shareholders who own at least 5 percent of the company for a minimum two-year holding period, the Act does not specify any minimum ownership threshold or holding period. The SEC has authority to grant an exemption to small issuers.

Say on Pay and Say on Golden Parachutes. Non-binding shareholder advisory votes on executive compensation must be held at least once every three years, at any annual or other meeting for which SEC proxy rules require disclosure of executive compensation. At the first annual or other meeting of shareholders that occurs six months after the date of enactment, public companies are required to include both a resolution providing shareholders with a non-binding advisory vote on executive compensation and a separate resolution to determine whether future "say-on-pay" votes should occur on an annual, biannual, or triennial basis. Public companies are also required to give shareholders a non-binding advisory vote on golden parachute compensation in connection with certain business combinations. The SEC has authority to grant an exemption to small issuers with regard to both say on pay and say on golden parachute votes.

No Majority Voting Requirement. A provision that would have required public companies to adopt a majority vote and resignation policy for uncontested elections was dropped during conference.

Executive Compensation Disclosures. The Act requires new executive compensation disclosure, including the ratio of CEO to employee compensation and any hedging activities by employees and directors with respect to equity compensation.

Compensation Committees. Compensation committee members of listed companies are required to satisfy heightened independence standards. Compensation committees of listed companies must consider specific factors identified by the SEC as affecting the independence of compensation consultants and advisers before selecting such advisers.

Clawback Provision. The Act requires the SEC, by rule, to direct national securities exchanges to prohibit the listing of any security of an issuer that does not develop and implement a policy to "clawback" compensation from executive officers who received incentive-based compensation (including stock options) during the three-year period preceding the date of an accounting restatement, in excess of what would have been paid under the accounting restatement. This provision is broader than the current Sarbanes-Oxley Act clawback provision.

Enhanced Disclosure and Reporting of Compensation Arrangements by Covered Financial Institutions with $1 Billion or More in Assets; Prohibition on Certain Compensation Arrangements. Not later than nine months after the date of enactment, appropriate federal regulators must jointly prescribe regulations or guidelines that:

- Require "covered financial institutions" to disclose to the appropriate federal regulator the structures of all incentive-based compensation arrangements sufficient to determine whether the compensation structure provides an executive officer, employee, director, or principal shareholder with excessive compensation, fees, or benefits, or could lead to material financial loss to the covered financial institution; and
- Prohibit any incentive-based payment arrangement that such regulators determine encourages "inappropriate

risks" by covered financial institutions, by providing an executive officer, employee, director, or principal shareholder with excessive compensation, fees, or benefits, or that could lead to material financial loss to the covered financial institution.

Reporting of the actual compensation of particular individuals is not required. "Covered financial institutions" include banks and savings associations and their respective holding companies, registered broker-dealers, credit unions, investment advisers, Fannie Mae, Freddie Mac, and any other financial institution that the appropriate federal regulators jointly determine should be treated as a covered financial institution. These requirements do not apply to covered financial institutions with assets of less than $1 billion.

Title X. Bureau of Consumer Financial Protection

Title X of the Act establishes a Bureau of Consumer Financial Protection (CFPB) within the Federal Reserve. The Director of the CFPB would be appointed by the President and confirmed by the Senate for a five-year term. While housed within the Federal Reserve, the CFPB would be required to operate without interference with regard to rulemaking, examinations, enforcement actions, and appointment or removal of employees, much in the same way that the OCC enjoys autonomy from the Treasury. The CFPB would be funded by the Federal Reserve in an amount determined to be "reasonably necessary" by the Director, subject to an annual funding cap.

Rulemaking Authority. The CFPB would be vested with the authority to promulgate regulations under certain federal consumer financial laws, including existing federal statutes for which the Federal Reserve or the US Department of Housing and Urban Development currently has rulemaking authority. These statutes include, among others:

- The Electronic Funds Transfer Act;
- The Equal Credit Opportunity Act;
- The Fair Credit Reporting Act;
- The Fair Debt Collection Practices Act;
- The Real Estate Settlement Procedures Act;
- The Truth in Lending Act;
- The Truth in Savings Act; and
- The Interstate Land Sales Full Disclosure Act (added during conference).

Notably, the Act preserves the Federal Trade Commission's (FTC's) authority to enforce the Federal Trade Commission Act against nonbank entities engaged in financial activities. The Act also gives the CFPB certain specific rulemaking authority to issue regulations to restrict the use of pre-dispute mandatory arbitration agreements, to prescribe requirements for consumer disclosures, and to identify and prohibit "unfair, deceptive, or abusive acts or practices." In addition, the Act requires the CFPB to make rules that would ensure that consumers gain access to their account information and receive timely responses to their complaints or inquiries.

There are several provisions that purport to place limitations on the CFPB. For example, the Act requires the CFPB to consult with the primary federal bank regulators before proposing a rule and during the comment process, and it must address any written objection of a primary federal bank regulator to its proposed rule in the adopting release. In addition, the FSOC may set aside a final regulation of the CFPB if two-thirds of the FSOC finds that the regulation would put the safety and soundness of the banking system or the stability of the financial system at risk. Furthermore, during the rulemaking process, the CFPB must collect advice and recommendations from small businesses about the potential impact of its regulations on small businesses, including the impact on the cost of credit to small businesses.

The regulations issued by the CFPB would apply to any "covered person," which is defined as any person engaged in offering or providing a consumer financial product or service (generally not including otherwise-regulated securities and insurance activities) and an affiliate that acts as a service provider to such a person. However, the Act makes it clear that the CFPB does not have authority over commercial transactions or the sale of nonfinancial goods or services. For example, the CFPB generally may not exercise authority with respect to a merchant, retailer, seller, or broker of nonfinancial goods or services. At conference, payday lenders, money remitters, check cashers, and private student loan providers were explicitly added to the supervision of the CFPB, while motor vehicle dealers were excluded. Pawn shop lenders do not appear to be subject to the supervision of the CFPB. Motor vehicle dealers and their financing operations are exempt to the extent that the source of the motor vehicle dealer's financing is a third party; however, motor vehicle dealers continue to be subject to FTC jurisdiction, and the FTC is given Administrative Procedure Act rulemaking powers over them.

Supervisory Authority. The CFPB would have examination and enforcement authority over all participants in the consumer mortgage arena, including mortgage originators, brokers, servicers, and consumer mortgage modification and foreclosure relief services. The CFPB also would have supervisory authority over larger non-depository institutions that offer or provide non-mortgage consumer financial products and services. Larger non-depository institutions are to be defined by regulations issued by the CFPB, in consultation with the FTC. While earlier versions of the legislation required the CFPB to prescribe rules on the registration of these non-depository institutions, the final Act permits, but does not require, the CFPB to impose such registration obligations.

With respect to depository institutions, the CFPB would have primary supervisory authority over only those insured depository institutions and credit unions with more than $10 billion in assets and the affiliates and service providers of such institutions. Banks, savings associations, and credit unions with assets of $10 billion or less would continue to be examined for consumer compliance by their primary federal bank regulators. The CFPB would have no authority to take enforcement action against them.

The CFPB would be required to coordinate examination and enforcement activities with the appropriate federal bank regulator and with state bank regulators where appropriate. If the proposed supervisory determinations of the CFPB and the primary federal bank regulator were to conflict, the conflict would be resolved either through the coordination of the two agencies, or through a governing panel. The governing panel would be composed of one representative each from the CFPB and the primary federal bank regulator, together with a representative from a federal bank regulator not involved in the dispute.

Preemption. The Act does not preempt any state law that provides greater protection for consumers, nor does it change the preemption standards or preemptive effect of any of the existing federal consumer banking laws. The Act also generally preserves preemption of state law for national banks under the National Bank Act and modifies it for federal savings banks under the Home Owners' Loan Act by codifying the standard for preempting state consumer financial law set forth in the 1996 US Supreme Court case *Barnett Bank* v. *Nelson*. Subsidiaries of these institutions would no longer be able to claim that federal law preemption principles that apply to their parent institutions also apply equally to them. Specifically, the Act codifies the standard for preempting state consumer financial law set forth in the 1996 US Supreme Court case *Barnett Bank* v. *Nelson*. Consistent with that standard, the Act provides that the National Bank Act and the Home Owners' Loan Act preempt state consumer law:

- When the state law would have a discriminatory effect on a national bank or federal savings bank in comparison with the effect of the law on a bank chartered by that state;
- If the state law prevents or significantly interferes with a national bank or federal savings bank's exercise of its power; or
- If the state law is preempted by another federal law.

The OCC as well as the courts are authorized to make determinations of preemption, on a "case-by-case" basis, under the above-referenced standard. If the OCC seeks to make a determination regarding preemption of a law of one state applicable to similar laws of other states, it must first consult with, and take into account the views of, the CFPB. The OCC is required to publish a list of its preemption determinations periodically. The Act does not disturb the applicability of any OCC or OTS preemption rules or opinions to contracts entered into prior to its enactment. It also does not affect the ability of a depository institution to export interest rates from any state in which the institution is located.

A state attorney general may bring a civil action in the name of the state to enforce regulations that the CFPB issues, but not the provisions of Title X itself, against a federally chartered institution. To that end, the visitorial standard for federally chartered institutions will remain the standard set forth in the 2009 US Supreme Court case *Cuomo* v. *Clearing House Association, L.L.C.* Under that standard, a state attorney general may bring a judicial action against a federally chartered institution to enforce an applicable law.

Debit Card Fee Restrictions. In an amendment that has implications for both card issuers and card networks, the Act imposes restrictions on the interchange fees that may be assessed in connection with certain debit card transactions. Specifically, the Federal Reserve is instructed in an amendment sponsored by Sen. Richard Durbin (D-Ill.) to issue regulations requiring debit card interchange fees to be "reasonable and proportional to the cost incurred by the issuer with respect to the transaction." Smaller card issuers (with less than $10 billion in assets) are exempted from these regulations, and during the House-Senate conference, reloadable prepaid cards and government-administered benefit cards were also exempted.

The Act also set limits on certain restrictions that payment card networks may impose. A payment card network (or issuer) may not require that a debit transaction be processed exclusively through a single network or inhibit a merchant from using other payment card networks to process debit transactions. A payment card network also may not inhibit the ability of merchants to offer discounts to customers who make payments by a certain means or to set a minimum purchase amount for payment by credit card (not to exceed $10), or inhibit the ability of federal agencies or colleges and universities to set a maximum dollar amount for payment by credit card, all of the above to the extent that the discount, minimum, or maximum does not differentiate between issuers or payment card networks.

Title XI. Federal Reserve System Provisions (Emergency Lending Authority and Debt Guarantee Programs)

Title XI of the Act requires the Federal Reserve to establish by regulation policies and procedures governing emergency lending programs. The programs must be of "broad based" applicability and designed to provide liquidity and not to aid a failing financial company. The programs must also be designed to ensure that the security for emergency loans is sufficient to protect taxpayers from losses and that the programs are terminated in a timely and orderly fashion. The Federal Reserve may not establish any emergency lending programs without the prior approval of the Treasury Secretary.

The Act also allows the FDIC to guarantee the debt of solvent insured depository institutions and their holding companies under certain circumstances. However, the FDIC may set up a facility to guarantee debt only if the FDIC and the Federal Reserve determine that there is a "liquidity event," that failure to take action would have serious adverse effects on the financial stability or economic conditions in the United States, and that guarantees are needed to avoid or mitigate the adverse effects. Furthermore, the FDIC may guarantee debt only up to a maximum amount established by the Treasury Secretary (in consultation with the President) and subsequently approved by a joint resolution in Congress. The FDIC's debt guarantee programs must be funded by fees and assessments on participants in the program, and to the extent the funds collected do not cover the program's losses, the FDIC would be required to impose a special assessment solely on participants in the program.

Title XII. Improving Access to Mainstream Financial Institutions

Title XII of the Act contains provisions intended to help unbanked and underbanked individuals gain access to mainstream financial services by authorizing government-subsidized programs that would be aimed at providing low- and moderate-income individuals with financial products or services, such as small loans, including loans that would be more consumer-friendly alternatives to payday loans. Such programs could also provide financial education and counseling.

Title XIV. Mortgage Reform and Anti-Predatory Lending Act

Title XIV creates new standards and prohibitions for residential mortgage lending to be supervised by the CFPB. These standards are designed to prevent the practices that were prevalent during the subprime mortgage crisis. Mortgages will be subject to a federal standard that would require the loans to reasonably reflect a borrower's ability to repay. A consumer may assert a lender's violation of this "ability to repay" standard as a defense to a foreclosure. A mortgage that fits certain qualifications will be presumed to meet this standard. These qualifications include:

- Mortgage payments do not result in an increase of the principal balance;
- No balloon payment;
- Borrower income and financial resources are verified;
- Underwriting is based upon the full amortization of the loan;
- Ratio of the borrower's total monthly debt to monthly income are within guidelines to be established by the federal reserve;
- Total points and fees do not exceed 3 percent of the loan amount; and
- The term of the loan does not exceed 30 years.

A mortgage that fits within these qualifications may not charge a prepayment penalty after the third year of the mortgage payment period. For variable rate mortgages, additional disclosures would be required six months prior to an interest rate reset. The disclosures must explain the calculation of the interest rate change, provide information on counseling agencies, and provide a list of alternatives for consumers prior to the interest rate reset, such as refinancing, renegotiating loan terms, or forbearing payment.

Title XIV also addresses mortgage broker practices. Specifically, the Act prohibits mortgage brokers from receiving compensation that varies based on the terms of the loan, including yield spread premiums. The Federal Reserve is required to draft regulations prohibiting mortgage brokers from steering consumers to predatory loans or loans that a borrower lacks a reasonable ability to repay. Mortgage brokers that are required to register under the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (S.A.F.E. Act) will be required to include their Nationwide Mortgage Licensing System and Registry number on all loan documents. Title XIV also requires the Federal Reserve to draft regulations requiring depository institutions to monitor the compliance of subsidiaries, as well as employees with the registration procedures under the S.A.F.E. Act.

Arnold & Porter is available to respond to questions raised by recent or forthcoming legislation, or to help guide your business towards legislative and regulatory solutions. We can assist in determining how pending bills and regulations may affect your business and industry. For further information, please contact your Arnold & Porter attorney or:

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