SENATE PASSES LANDMARK FINANCIAL REGULATORY REFORM BILL

The Restoring American Financial Stability Act of 2010 (Senate Bill) was passed by the Senate on Thursday, May 20, 2010, by a vote of 59-39.[1] The legislation now proceeds to a House-Senate conference to reconcile differences between the Senate version, originally introduced by Sen. Christopher Dodd (D-Conn.), and the House version, originally introduced by Rep. Barney Frank (D-Mass.) and passed in December 2009 (House Bill). It is anticipated that the conference will last approximately four weeks and that the final legislation could be ready for President Obama's signature as early as the July 4, 2010 congressional recess. If enacted, the pending legislation would represent perhaps the most sweeping overhaul of the US financial sector since the Great Depression. It expands federal regulation of the financial industry and creates a new agency to oversee consumer protection issues. It also introduces systemic risk monitoring and new resolution mechanisms for the largest and most significant institutions in an attempt to avoid future financial crises.

This advisory provides a preliminary overview of the Senate Bill in title order. It is not intended to serve as a detailed analysis or summary of the legislation. Because the language of the final Senate Bill is not yet available, this summary was prepared on the basis of the best available information. Arnold & Porter LLP will provide more detailed analyses and summaries of the final financial reform legislation after it becomes law. Meanwhile, readers can access a current copy of the Senate Bill as well as other information on recent government programs, on our regularly updated Financial Regulatory Chart, *available at:* http://www.arnoldporter.com/resources/documents/FinancialRegulatoryChart.pdf.

I. FINANCIAL STABILITY

Title I of the Senate Bill creates a Financial Stability Oversight Council (FSOC) to address systemic risk in the financial system. The FSOC can subject certain bank holding companies and 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). It could also subject such companies to stricter standards, including higher capital requirements, leverage limits, liquidity requirements, concentration limits, resolution plan and credit exposure requirements, enhanced public

1 The Senate adopted the number of the House Bill, H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009. The Senate Bill was previously S. 3217.

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Economic Recovery and the Changing Regulatory Landscape

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disclosures, and overall risk management requirements. The standards would not apply to any bank holding company with total consolidated assets of less than US$50 billion. While there is no such floor for nonbank financial companies, only the largest such companies likely would be covered. The Title defines "nonbank financial companies" as those companies, other than bank holding companies or their subsidiaries, whose revenues from financial activities comprise at least 85 percent of the consolidated annual gross revenues of the company or whose consolidated assets that are financial in nature or incidental to a financial activity comprise at least 85 percent of the consolidated assets of the company.

The FSOC may also make recommendations to the primary federal bank regulators 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 or the financial markets of the United States. A primary federal bank regulator must impose the standards recommended by the FSOC, or similar standards that the FSOC deems acceptable, or explain no later than 90 days after the date of the recommendation its reasons for not following the recommendation. The Senate Bill 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 or bank holding company with consolidated assets greater than US$50 billion, or force such company to sell assets if necessary to mitigate a threat to the financial stability of the United States.

II. ORDERLY LIQUIDATION AUTHORITY

To prevent future taxpayer bailouts of firms deemed "too big to fail," Title II of the Senate Bill gives the Federal Deposit Insurance Corporation (FDIC) power to unwind large failing bank holding companies and other nonbank financial companies. 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 Senate Bill 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 Senate Bill must be approved by the Federal Reserve, the FDIC, and the Secretary of the Treasury (in consultation with the President). If the failing company does not consent to the appointment of the FDIC as receiver, the 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 Senate Bill explicitly prohibits use of taxpayer funds to rescue a failing financial firm. Instead, the costs of unwinding a firm would be paid with an after-the-fact assessment on financial companies with at least US$50 billion in total consolidated assets and on any nonbank financial companies supervised by the Federal Reserve. The House Bill, by contrast, establishes an up-front US$150 billion liquidation fund financed by a fee on large financial institutions.

III. TRANSFER OF POWERS TO THE OCC, FDIC, AND FEDERAL RESERVE

Title III of the Senate Bill 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, the OTS rulemaking authority is divided between the Federal Reserve and 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. In conjunction with these expanded responsibilities, the Federal Reserve, the FDIC, and the OCC are each given additional authority to levy assessments on the institutions they supervise to cover the agencies' costs. The changes made by the Senate Bill generally become effective one year from enactment of the legislation, which is extendable by the Secretary of the Treasury for up to six additional months (Transfer Date). The abolition of the OTS becomes effective 90 days after the Transfer Date.

The Senate Bill prohibits the issuance of new federal thrift charters as of the enactment of the legislation. While it does not mandate the conversion of existing federal thrift charters to bank charters, 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. The Bill provides for the prospective repeal of Section 5 of the Home Owners' Loan Act once no federal savings associations remain.

IV. REGULATION OF ADVISERS TO HEDGE FUNDS AND OTHERS

Title IV of the Senate Bill amends the Investment Advisers Act of 1940 (Advisers Act) to impose US Securities and Exchange Commission (SEC) registration, reporting, and record keeping obligations on investment advisers to "private funds." A "private fund" is defined as an issuer that would be an investment company under the Investment Company Act of 1940 (ICA) but for exceptions in Section 3(c)(1) (for funds with fewer than 100 investors) or Section 3(c)(7) (for funds owned exclusively by "qualified purchasers") of the ICA. Advisers to such funds, with certain limited exceptions, would become subject to Advisers Act regulation through an amendment that eliminates the current exemption from the Advisers Act for 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.[2]

Records and Reports. Registered private fund advisers must maintain and keep records of private funds that they advise, for such period as the SEC may prescribe by rule. Records and reports required to be maintained by a private fund include the amount of assets under management; use of 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; and trading practices. Private funds must also maintain records and reports on other information that the SEC, in consultation with the FSOC, determines is necessary or appropriate. The SEC may establish different reporting requirements for different classes of fund advisers, based on the type or size of private fund being advised.

Increase in Statutory Asset Threshold for Federal Registration of Investment Advisers. The Senate Bill raises the statutory asset threshold for federal registration of investment advisers generally (and not just advisers to private funds) from US$25 million to US$100 million (or such higher amount as the SEC specifies by rule). Investment advisers with less than US$100 million in assets under management are subject to state regulation.

Custody Requirement. The Senate Bill adds a section to the Advisers Act that requires registered investment

2 The elimination of the "fewer than 15" client exemption from Advisers Act registration is applicable to investment advisers generally, other than those that qualify as a "foreign private adviser" under a new exemption.

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

Effective Date. The effective date for the private fund provisions is generally one year after the date of enactment of the legislation. 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.

Accredited Investors. The Senate Bill directs that changes be made to increase the net-worth required to qualify as an "accredited investor" under the Securities Act of 1933, primarily by excluding the value of a primary residence from the calculation. The Bill further instructs the SEC to conduct a review, to be updated at least every four years, to determine whether the "accredited investor" definition should be modified for the protection of investors or to further the public interest.

V. INSURANCE

Title V of the Senate Bill establishes an Office of National Insurance (Office) within the US Department of the Treasury that will be responsible for comprehensive monitoring of the insurance industry (other than health insurance and crop insurance). The Office will be 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 Office 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 Senate Bill also authorizes the Office 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. It authorizes the Secretary of the Treasury to negotiate and enter into international insurance agreements on prudential measures on behalf of the United States, in consultation with the United States Trade Representative. The Office 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 Senate Bill 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 Senate Bill provides that the state of domicile of the reinsurer is solely responsible for regulating the financial solvency of the reinsurer.

VI. IMPROVEMENTS TO REGULATION OF BANK AND SAVINGS ASSOCIATION HOLDING COMPANIES AND DEPOSITORY INSTITUTIONS

Title VI of the Senate Bill 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 the merger or whole acquisition of a commercial firm that directly or indirectly controls the industrial loan company, credit card bank, or trust bank in a *bona fide* merger with or acquisition by another commercial firm. The Senate Bill 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

(BHCA) 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.

In order to aid a consolidated supervisor's ability to identify and address risk throughout an organization, the Senate Bill 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 Senate Bill 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.

Significantly, the Senate Bill requires federal regulators to implement restrictions on the capital market activities engaged in by insured depository institutions, their holding companies, and any subsidiary of such institution or holding company. In particular, and subject to certain exemptions, federal regulators must issue regulations to prohibit insured depository institutions, their holding companies, and any subsidiary of such institution or holding company from proprietary trading, sponsoring, and 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.

Moreover, the Senate Bill 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, such that a financial company 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 Senate Bill 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, and reverse repurchase agreements as extensions of credit for purposes of national bank lending limits; and
- require all insured depository institutions, including insured state banks, to comply with national bank lending limits.

In addition, an amendment authored by Sen. Susan Collins (R-Maine) gives federal regulators the authority to impose minimum leverage and risk-based capital requirements on depository institutions, depository institution holding companies, and nonbank financial companies identified by the new FSOC as subject to increased supervision by the Federal Reserve to reflect the risks of their activities. In addition, the capital requirements of the Prompt Corrective Action provisions of Federal Deposit Insurance Act would be uniformly imposed on a consolidated basis on all depository institutions, their holding companies, and nonbank financial companies that may be determined to be subject to systemic risk (with the result that trust-preferred securities would appear no longer to be eligible for Tier 1 capital treatment).

VII. WALL STREET TRANSPARENCY AND ACCOUNTABILITY (OVER-THE-COUNTER DERIVATIVES)

Title VII of the Senate Bill 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 Senate Bill increases the regulatory requirements imposed on various financial entities that utilize derivatives products. More specifically, the Senate Bill regulates "swap dealers" and "major swap participants," whose definitions would likely include banks, large hedge funds, and possibly even large insurance and 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 Senate Bill amends the Commodity Exchange Act to implement mandatory clearing of swaps on clearinghouses. In general, the Commodity Futures Trading Commission (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. A narrow exemption from such clearing requirements is provided for "commercial end-users," generally defined as entities, other than financial entities, whose primary business activity is to own, produce, manufacture, distribute, or merchandise goods, services, or commodities.

The Senate Bill 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. Finally, one of the most far-reaching provisions in the Senate Bill's derivatives section, and likely the biggest departure from the House Bill's treatment of derivatives, is the Senate Bill's requirement that banks divest their derivatives operations (possibly to affiliates) in order to receive any type of federal assistance, including federal deposit insurance and access to the Federal Reserve's discount window.

VIII. PAYMENT, CLEARING, AND SETTLEMENT SUPERVISION

Title VIII of the Senate Bill 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 Senate Bill 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 Senate Bill 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 systemically important FMU to borrow from a Federal Reserve Bank under the same privileges available to a depository institution. The Senate Bill 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 both the Federal Reserve and the FSOC.

IX. INVESTOR PROTECTIONS AND IMPROVEMENTS TO THE REGULATION OF SECURITIES

In order to address practices believed to have played a major role in the recent financial crisis, Title IX of the Senate Bill 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 Senate Bill directs regulators to issue rules requiring lenders to retain credit risk in asset-backed securities that they package or sell. 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.

To address the conflicts raised by the traditional "issuer pays" model of securing credit ratings, an amendment to the Senate Bill offered by Sen. Al Franken (D-Minn.) creates a Credit Rating Agency Board overseen by the SEC. Rather than allow securitizers to continue selecting rating agencies, the new agency would assign a rating agency to provide the initial rating of an asset-backed security. It would also assess the accuracy of ratings on an annual basis. The Senate Bill 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 Senate Bill 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 Senate Bill eases pleading standards in plaintiffs' actions against credit rating agencies and subjects statements by rating agencies to potential enforcement actions, similar to those registered public accountants and securities analysts.

For broker-dealers, the legislation includes several items of particular note. The Senate Bill does not impose fiduciary standards on broker-dealers, as was originally proposed. Instead, it directs the SEC to conduct a study of the differences between the standards of care that apply to broker-dealers and investment advisers when dealing with retail customers, and to report to Congress on any gaps or overlaps. If it finds such gaps or overlaps, the SEC, using its existing rulemaking authority, is directed to issue rules to address them.

On a more substantive basis, the Senate Bill 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 place restrictions on mandatory pre-dispute arbitration clauses in broker-dealer account agreements.

The Senate Bill 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;
- 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; and
- removes the exemption from registration for offers or sales of promissory notes secured by first liens on single parcels of land on which dwellings or commercial structures are located.

The Senate Bill 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.

The Senate Bill includes corporate governance and executive compensation provisions that primarily affect public companies. It also amends the BHCA to prohibit bank holding companies from paying "excessive compensation" to executive officers, employees, directors, and principal shareholders. It is unclear if this provision would apply to other depository institution holding companies.

Public companies are required to provide shareholders with an annual non-binding shareholder advisory vote on the compensation of executives. Public companies are also required to adopt a majority vote standard in uncontested elections. The Senate Bill gives the SEC authority to issue rules permitting shareholders to nominate directors in a company's proxy materials. The Senate Bill also directs the SEC to require several disclosures relating to executive compensation, such as the ratio of CEO to employee compensation and any hedging activities by employees and directors with respect to equity compensation. Compensation committee members of listed companies are required to satisfy heightened independence standards.

The Senate Bill also requires listed companies to develop and implement a policy to "clawback" excessive compensation from executive officers who received incentive-based compensation (including stock options) during the three-year period preceding the date of an accounting restatement. This provision is broader than the current clawback provision that was adopted under the Sarbanes-Oxley Act.

X. BUREAU OF CONSUMER FINANCIAL PROTECTION

Title X of the Senate Bill establishes a Bureau of Consumer Financial Protection (BCFP) within the Federal Reserve. The Director of the BCFP would be appointed by the President and confirmed by the Senate for a five-year term. While housed within the Federal Reserve, the BCFP would 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 BCFP 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 BCFP 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, and the Truth in Savings Act. Notably, the Senate Bill preserves the Federal Trade Commission's authority to enforce the Federal Trade Commission Act against nonbank entities engaged in financial activities. The Senate Bill also gives the BCFP 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 Senate Bill requires the BCFP 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 BCFP. For example, the Senate Bill requires the BCFP 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 BCFP 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 BCFP 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 BCFP 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 Senate Bill, like the House Bill, makes it clear that the BCFP does not have authority over commercial transactions or the sale of nonfinancial goods or services. For example, the BCFP generally may not exercise authority with respect to a merchant, retailer, seller, or broker of nonfinancial goods or services. Unlike the House Bill, the Senate Bill does not contain any exemption for auto dealers or affiliated financial service providers. However, on May 24, 2010, the Senate adopted a motion to instruct the members of the House-Senate conference to accept the provision in the House Bill that would provide an exemption for auto dealers and their financing operations to the extent that the source of the financing is a third-party.

Supervisory Authority. The BCFP 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 BCFP 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 BCFP, in consultation with the Federal Trade Commission. The House Bill would not limit the BCFP's supervisory authority over non-depository institution providers of non-mortgage consumer financial products and services to "larger" institutions. Non-depository covered persons subject to the BCFP's supervisory authority would be required to register with the BCFP.

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

The BCFP 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 BCFP and the primary federal bank regulator conflicted, 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 BCFP and the primary federal bank regulator, together with a representative from a federal bank regulator not involved in the dispute.

Preemption. The Senate Bill does not preempt any state law that provides greater protection for consumers, nor does it change the preemptive standards or effect of any of the existing federal consumer banking laws. However, the Senate Bill does preserve some federal law preemption for national banks and federal savings banks. Specifically, the Senate Bill 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 Senate Bill provides that a state consumer law can be preempted (1) when the state law would have a discriminatory effect on federally chartered institutions in comparison with the effect of the law on a bank chartered by that state, (2) if the state law prevents or significantly interferes with a federally chartered institution's exercise of its power, or (3) if the state law is preempted by another federal law. Prior to making a determination under the standard, the OCC must follow certain procedures, including consultation with the BCFP. The OCC is required to publish a list of its preemption determinations periodically. State law is not preempted with respect to state-chartered non-depository institution subsidiaries, affiliates, and agents of federally chartered institutions. The Senate Bill does not disturb the applicability of any OCC or OTS preemption rules 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 BCFP 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. The Senate Bill also imposes restrictions on the interchange fees that may be assessed in connection with 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 actual cost incurred by the issuer or payment card network with respect to the transaction." Smaller card issuers (with less than US$10 billion in assets) are exempted from this requirement. Prohibitions currently imposed by most payment card networks on minimum or maximum transaction amounts and on form-of-payment discounts are also banned by the Senate Bill.

XI. FEDERAL RESERVE SYSTEM PROVISIONS (EMERGENCY LENDING AUTHORITY AND DEBT GUARANTEE PROGRAMS)

Title XI of the Senate Bill requires the Federal Reserve to establish by regulation policies and procedures governing emergency lending. These programs must be designed to provide liquidity and not to aid a failing financial company. The Senate Bill 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 FSOC 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 Secretary of the Treasury and submitted by the President to Congress, provided Congress does not disapprove of the request. 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.

XII. IMPROVING ACCESS TO MAINSTREAM FINANCIAL INSTITUTIONS

Title XII of the Senate Bill is intended to help unbanked and underbanked individuals gain access to mainstream financial services by authorizing government-subsidized programs that provide 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.

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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