
Financial Services Regulatory Highlights

June 2011

Bank Agency Final Rule Establishes a Risk-Based Capital Floor	1
Bank Agency Stress Testing Guidance for Large Banking Organizations	2
CFPB Releases Consumer Proposal Defining “Larger Participants”	4
CFPB Requests Comment on List of Rules and Orders It Would Enforce	4
CFTC Holds Roundtable on Cleared Swap Customer Collateral	6
CFTC Holds Roundtable on Swap Data Reporting and Unique Product Identifiers	7
CFTC Proposes Temporary Relief from Title VII Swap Provisions	7
EU Commissioner Michel Barnier Urges Coordination and Consistency in Financial Regulatory Reform.....	9
FDIC Establishes Advisory Committee on Systemic Resolutions	9
GAO Report on Modified Prompt Corrective Action Framework	10
OCC and FDIC Release List of OTS Regulations Each Will Enforce	11
OCC Issues Proposed Guidance on Deposit-Related Consumer Credit Products.....	11
OCC Proposed Rules on Supervision of Thrifts Subject to OTS Supervision	13
SEC Adopts New Whistleblower Rule	14
SEC Adopts Private Fund Adviser Registration and Other Investment Advisor Rules	16
SEC Announces Steps to Address One-Year Effective Date of Dodd-Frank	19
SEC Provides Temporary Relief from Regulation of Security-Based Swaps	19
SEC Issues Final Rule on Beneficial Ownership Reporting Requirements and Security-Based Swaps	20
SEC Proposes Exemptions from Registration Requirement for Security-Based Swaps Issued by Clearing Agencies.....	21
Senate “Stop and Study” FRB Interchange Amendment Fails	21
Treasury Secretary Geithner Addresses Challenges to Completing Financial Reforms – Urges International Margin Standard for Uncleared Derivatives	21
Additional Information.....	23

Bank Agency Final Rule Establishes a Risk-Based Capital Floor

On June 14, 2011 the Federal Reserve Board, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation adopted a final rule that establishes a floor for the risk-based capital requirements (advanced approaches rules) applicable to the largest, internationally active banking organizations. The final rule also provides flexibility for certain low-risk assets held by depository institution holding companies or by nonbank financial companies that are supervised

by the Financial Stability Oversight Council. The rule implements Section 171 of the Dodd-Frank Act.

Under the final rule, banking organizations operating under the Agencies’ advanced approaches risk-based capital rules (Basel II) are required to meet the higher of the minimum requirements under the general risk-based capital rules (PCA guidelines) and the minimum requirements under Basel II, thereby eliminating the transitional floors permitted under the 2007 final rule



issued by the Agencies implementing Basel II. The minimum PCA capital levels are considered the “permanent floor.” For bank holding companies subject to Basel II, the final rule provides that they must calculate their floor requirement under the general risk-based capital rules for state member banks. However, in accordance with Dodd-Frank, these organizations may include certain debt or equity instruments issued before May 19, 2010 as described in section 171(b)(4)(B). The Agencies expect the phase-in of restrictions on the regulatory capital treatment of the debt or equity instruments will be addressed in more detail in future rulemaking.

The rule also provides flexibility to establish appropriate capital requirements for certain low-risk exposures. Under the general risk-based capital rules, these exposures would be assigned to the 100% risk weight. The final rule permits a lower risk weight if a bank is not authorized to hold the asset under applicable law, except under the authority to hold an asset in connection with the satisfaction of a debt previously contracted or similar authority, and the risks associated with the asset are

substantially similar to the risks of other assets that otherwise are assigned a risk weight of less than 100% under the general risk-based capital rules. However, the Agencies retain reservation of authority to assign alternate risk-based capital requirements, as deemed appropriate.

The Agencies received several comments during the comment period regarding perceived competitive advantages of foreign banking organizations, as the capital floors are not applicable to such organizations. In addition, the Agencies received comments regarding the interaction of the capital floor with the implementation of Basel III. The Agencies are continuing to study these issues and will work with the international supervisory community through the Basel Committee. The Agencies anticipate performing a quantitative analysis to ensure that future changes to capital requirements result in minimum capital requirements that are not “quantitatively lower” than the “generally applicable” capital requirements for insured depository institutions, as required by the Dodd-Frank Act.

Bank Agency Stress Testing Guidance for Large Banking Organizations

On June 9, 2011, the Federal Reserve Board, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation issued proposed joint guidance outlining high-level principles for stress testing practices for certain large bank organizations. The guidance emphasizes the importance of stress testing as an “ongoing risk management practice” that supports banking organizations forward-looking assessment of risks and better equips them to address a range of adverse outcomes.

The proposed guidance would apply to all banking organizations supervised by the agencies that have more than \$10 billion in total consolidated assets. These banking organizations include national banks, state chartered insured banks, branches and agencies of foreign banks and bank holding companies. The proposed guidance does not explicitly address the stress-testing requirements in the Dodd-Frank Act for

systemically important financial institutions (SIFIs), but the agencies indicate that they expect to implement the SIFI provisions in a future rulemaking.

The proposed guidance defines stress testing as “exercises used to conduct a forward-looking assessment of the potential impact of various adverse events and circumstances on a banking organization. Stress testing occurs at various levels of aggregation, including on an enterprise-wide basis.”

The guidance establishes four general principles for stress-testing, describes several common approaches and applications, underlines the importance of stress-testing for capital adequacy and liquidity, and concludes with expectations for corporate governance.



General Stress Testing Principles

Under the guidance, a banking organization is expected to develop and implement “an effective stress testing framework as part of its broader risk management and governance processes.” As such, the stress testing framework should:

- Include activities and exercises that are tailored to and sufficiently capture the banking organization’s full set of material activities, exposures, and risks, whether on or off the balance sheet;
- Employ multiple conceptually sound stress testing activities and approaches and relies on high-quality input data and information to produce credible outcomes;
- Be forward-looking and sufficiently dynamic and flexible to incorporate changes in a banking organization’s (i) on- and off-balance-sheet activities, (ii) portfolio composition, (iii) asset quality, (iv) operating environment, (v) business strategy, and (vi) other risks that may arise over time from firm-specific events, macroeconomic and financial market developments, or (vii) some combination of these events; and
- Produce clear, actionable and well supported results to inform decision-making. Stress testing should incorporate measures that adequately and effectively convey results of the impact of adverse outcomes, such as changes to asset values, accounting and economic profit and loss, revenue streams, liquidity levels, cash flows, regulatory capital, risk weighted assets, loan loss provisions, internal capital estimates, levels of problem assets, breaches in covenants or key trigger levels, or other relevant measures.

The uses of a banking organization’s stress testing framework is expected to include, but not be limited to: (i) augmenting risk identification and measurement; (ii) estimating business line revenues and losses and informing business line strategies; (iii) identifying vulnerabilities and assessing their potential impact; (iv) assessing capital adequacy and enhancing capital planning; (v) assessing liquidity adequacy and informing contingency funding plans; (vi) contributing to strategic planning; (vii) enabling senior management to better

integrate strategy, risk management, and capital and liquidity planning decisions; and (viii) assisting with recovery planning.

Stress-Testing Approaches and Applications

The proposed guidance includes descriptions of four approaches to stress-testing – scenario analysis, sensitivity analysis, enterprise-wide stress-testing and reverse stress testing. Scenario analysis refers to a type of stress testing in which a banking organization applies historical or hypothetical scenarios to assess the impact of various events and circumstances, including extreme ones. Sensitivity analysis refers to a banking organization’s assessment of its exposures, activities, and risks when certain variables, parameters and inputs are “stressed” or “shocked.” A key goal of sensitivity analysis is to test the impact of assumptions on outcomes. While enterprise-wide stress tests can help a banking organization in its efforts to assess the impact of its full set of risks under adverse events and circumstances, it should nonetheless be supplemented with other stress tests and other risk measurement tools given inherent limitations in capturing all risks and all adverse outcomes in one test. Reverse stress testing allows a banking organization to assume a known adverse outcome, such as suffering a credit loss that breaches regulatory capital ratios or suffering severe liquidity constraints making it unable to meet its obligations, and then deduce the types of events that could lead to such an outcome.

Stress-Testing for Evaluating Adequacy of Capital and Liquidity

Given the importance of capital and liquidity to a banking organization’s viability, the proposed guidance states that stress-testing should be applied in these two areas in particular, including an evaluation of the interaction between capital and liquidity and the potential for both to become impaired at the same time. Further, the proposed guidance provides that stress testing for capital and liquidity adequacy should be conducted in coordination with a banking organization’s overall strategy and annual planning cycles, and that results should be refreshed in the event of major strategic decisions, or other decisions that can materially impact capital or liquidity.

Governance

Finally, the proposed guidance discusses governance. According to the guidance, a banking organization's stress testing framework will be effective only if it is subject to strong governance and controls to ensure the framework is functioning as intended. Governance over a banking organization's stress testing framework rests with the banking organization's board of directors and senior management. As part of their overall responsibilities, a banking organization's board and

senior management should establish a comprehensive, integrated and effective stress testing framework that fits into the broader risk management of the institution. A banking organization also should have written policies, approved and annually reviewed by the board, that direct and govern the implementation of the stress testing framework in a comprehensive manner.

Comments on the proposed guidance are due by July 29, 2011.

CFPB Releases Consumer Proposal Defining “Larger Participants”

On June 23, 2011, the Consumer Financial Protection Bureau (CFPB) released a notice and request for public comment on the CFPB's statutory requirement to define “larger participant” in certain consumer financial markets.

Section 1024 of Dodd-Frank provides that the CFPB may supervise “covered persons” in the residential mortgage, private education lending, and payday lending markets. For other markets, the supervision program generally will apply only to a “larger participant” in the market. The CFPB must define such “larger participants” no later than July 21, 2012. The “larger participant” rule will not impose new substantive consumer protection requirements on any non-depository entity, but will

provide to the CFPB the authority to supervise larger participants, including the conduct of supervisory examinations and requiring periodic reporting, to ensure compliance with Federal consumer financial law.

The CFPB sought public comment on the development of a rule to identify a “larger participant” of a market for consumer financial products or services. The CFPB has identified the following markets for possible inclusion in an initial rule: debt collection; consumer reporting; consumer credit and related activities; money transmitting, check cashing and related activities; prepaid cards; and debt relief services.

CFPB Requests Comment on List of Rules and Orders It Would Enforce

On May 31, 2011, the CFPB published a list of rules that it would enforce pursuant to Section 1063(i) of the Dodd-Frank Act. Subject to the limitations of the Act, the CFPB will be authorized to enforce, rules and orders issued by the Agencies under the “enumerated consumer laws”, as defined in the Act. Section 1063(i) provides that, not later than the designated transfer date (July 21, 2011), the CFPB “(1) shall, after consultation with the head of each transferor agency, identify the rules and orders that will be enforced by the Bureau; and (2) shall publish a list of such rules and orders in the Federal Register.” The CFPB will consider public comment until

June 30, 2011 and publish a final list in the Federal Register no later than July 21, 2011.

The CFPB developed the list of rules below for proposed transfer to their mandate:

Federal Reserve Board

- Regulation B- Equal Credit Opportunity Act (12 CFR Part 202)
- Regulation C - Home Mortgage Disclosure (12 CFR Part 203)



- Regulation E - Electronic Fund Transfers (12 CFR Part 205)
- Regulation H Subpart I— Registration of Residential Mortgage Loan Originators (12 CFR 208.101–105 & Appendix A to Subpart I)
- Regulation M - Consumer Leasing (12 CFR Part 213)
- Regulation P -Privacy of Consumer Financial Information (12 CFR Part 216)
- Regulation V - Fair Credit Reporting, except with respect to §§ 222.1(c) (effective dates), 222.83 (Disposal of consumer information), 222.90 (Duties regarding the detection, prevention, and mitigation of identity theft), 222.91 (Duties of card issuers regarding changes of address), & Appendix J (Interagency Guidelines on Identity Theft Detection, Prevention, and Mitigation) (12 CFR Part 222)
- Regulation Z -Truth in Lending (12 CFR Part 226)
- Regulation DD -Truth in Savings (12 CFR Part 230)

Federal Deposit Insurance Corporation

- Privacy of Consumer Financial Information (12 CFR Part 332)
- Fair Credit Reporting (12 CFR Part 334), except with respect to §§ 334.83 (Disposal of consumer information), 334.90 (Duties regarding the detection, prevention, and mitigation of identity theft), 334.91 (Duties of card issuers regarding changes of address), & Appendix J (Interagency Guidelines on Identity Theft Detection, Prevention, and Mitigation)
- Registration of Residential Mortgage Loan Originators (12 CFR 365.101-.105 & Appendix A to Subpart B)

Office of Comptroller of Currency

- Adjustable-Rate Mortgages (12 CFR 34.20 .25) (but only as applied to non federally chartered housing creditors under the Alternative Mortgage Transaction Parity Act (“AMTPA”))
- Registration of Residential Mortgage Loan Originators (12 CFR 34.101 -.105 & Appendix A to Subpart F)
- Privacy of Consumer Financial Information (12 CFR Part 40)
- Fair Credit Reporting (12 CFR Part 40), except with respect to §§ 41.83 (Disposal of consumer

information), 41.90 (Duties regarding the detection, prevention, and mitigation of identity theft), 41.91 (Duties of card issuers regarding changes of address), & Appendix J (Interagency Guidelines on Identity Theft Detection, Prevention, and Mitigation)

Office of Thrift Supervision

- Adjustments to home loans (12 CFR 560.35) (but only as applied to non federally chartered housing creditors under AMTPA)
- Alternative Mortgage Transactions (12 CFR 560.210 - 220) (but only as it relates to AMTPA)
- Registration of Residential Mortgage Loan Originators (12 CFR 563.101 - .105 & Appendix A to Subpart D)
- Fair Credit Reporting (12 CFR Part 571), except with respect to §§ 571.83 (Disposal of consumer information), 571.90 (Duties regarding the detection, prevention, and mitigation of identity theft), 571.91 (Duties of card issuers regarding change of address), & Appendix J (Interagency Guidelines on Identity Theft Detection, Prevention, and Mitigation)
- Privacy of Consumer Financial Information (12 CFR Part 573)

National Credit Union Association

- Loans to members and lines of credit to members (12 CFR 701.21) (but only as applied to non-federally chartered housing creditors under AMTPA)
- Truth in Savings (12 CFR 701.21)
- Privacy of Consumer Financial Information (12 CFR Part 716)
- Fair Credit Reporting (12 CFR Part 716), except with respect to §§ 717.83 (Disposal of consumer information), 717.90 (Duties regarding the detection, prevention, and mitigation of identity theft), 717.91 (Duties of card issuers regarding changes of address), & Appendix J (Interagency Guidelines on Identity Theft Detection, Prevention, and Mitigation)
- Requirements for Insurance (12 CFR Part 741), but only with respect to §§ 741.217 (Truth in savings), 741.220 (Privacy of consumer financial information), & 741.223 (Registration of residential mortgage loan originators)



- Registration of Mortgage Loan Originators (12 CFR Part 761)

Federal Trade Commission

- Telemarketing Sales Rule (16 CFR Part 310)
- Privacy of Consumer Financial Information (16 CFR Part 310)
- Disclosure Requirements for Depository Institutions Lacking Federal Depository Insurance (16 CFR Part 320)
- Mortgage Assistance Relief Services (16 CFR Part 322)
- Use of Prenotification Negative Option Plans (16 CFR Part 425)
- Rule Concerning Cooling-Off Period for Sales Made at Homes or at Certain Other Locations (16 CFR Part 429)
- Preservation of Consumers' Claims and Defenses (16 CFR Part 433)
- Credit Practices (16 CFR Part 444)
- Mail or Telephone Order Merchandise (16 CFR Part 435)
- Disclosure Requirements and Prohibitions Concerning Franchising (16 CFR Part 436)
- Disclosure Requirements and Prohibitions Concerning Business Opportunities (16 CFR Part 437)
- Fair Credit Reporting Act (16 CFR Subchapter F, Parts 603 et seq), except with respect to Part 681

(Identity Theft Rules), Part 682 (Disposal of Consumer Report Information and Records), & Appendix A to Part 681 (Interagency Guidelines on Identity Theft Detection, Prevention, and Mitigation)

- Procedures for State Application for Exemption from the Provisions of the [Fair Debt Collection Practices] Act (16 CFR Part 310)

Department of Housing and Urban Development

- Hearing Procedures Pursuant to the Administrative Procedure Act (24 CFR 26.28-.56)
- Civil Money Penalties: Certain Prohibited Conduct (24 CFR Part 30) (but only as applied to the Real Estate Settlement Procedures Act of 1974 ("RESPA") and the Interstate Land Sales Full Disclosure Act ("ILSA"))
- Land Registration (24 CFR Part 1710)
- Purchasers' Revocation Rights, Sales Practices, and Standards (24 CFR Part 1715)
- Formal Procedures and Rules of Practice (24 CFR Part 1720)
- Real Estate Settlement Procedures Act (24 CFR Part 3500)
- Investigations in Consumer Regulatory Programs (but only as applied to RESPA and ILSA) (24 CFR Part 3800)

CFTC Holds Roundtable on Cleared Swap Customer Collateral

On June 3, 2011, the CFTC held a public roundtable discussion of issues related to the protection of cleared swaps customer collateral under the Dodd Frank Act. Dodd Frank creates general rules for segregation and handling of customer collateral for cleared swaps. The CFTC has issued two rulemakings to discuss options for implementing the Dodd-Frank requirements. The first sought comments on four possible models for treatment of cleared swap customer collateral. The second rulemaking selected one of these models, termed

"Complete Legal Segregation with Commingling." Industry representatives and market intermediaries discussed the merits of each model. In broad terms, representatives of the asset management industry favored maximum segregation and protection of their collateral, preferably with third party custodians. Investment banks and sell-side representative discussed the challenges of administering customer specific collateral management, versus the omnibus approach permitted currently for futures.

CFTC Holds Roundtable on Swap Data Reporting and Unique Product Identifiers

On June 8, 2011, the Commodity Futures Trading Commission held a public roundtable on June 8, 2011, from 1:00 pm to 5:00 pm to discuss technical aspects of implementing infrastructures for issuance and maintenance of Unique Product Identifiers (UPIs), as they apply to CFTC's proposed swap data recordkeeping and reporting rules, as well as other CFTC proposed rules, with a focus on the products and entities under the Commission's jurisdiction. The roundtable will assist the CFTC in the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The Unique Product Identifier (UPI) proposed by the Commission in the swap data recordkeeping and reporting rulemaking (Part 45) would categorize swaps according to the underlying products referenced in them. While the UPI would be assigned to a particular level of the taxonomy of the asset class or sub-asset class in

question, its existence would enable the Commission and other regulators to aggregate transactions at various taxonomy levels based on the type of product underlying the swap.

Issues to be addressed at the Public Roundtable include:

- Discussion about the existing systems of swap product classification and identification currently available.
- Coordination among various industry product classification and identification work-streams for the purpose of achieving a universal method to describe and classify swap products.
- Implementation of a universal system of swap product classification and identification for the purpose of meeting various CFTC requirements.

CFTC Proposes Temporary Relief from Title VII Swap Provisions

On June 14, 2011, the CFTC proposed to exempt temporarily swap market participants from compliance with most of the swaps provisions in Title VII of the Dodd-Frank Act that will become effective on July 16, 2011. Its proposed exemptive order would extend relief to affected persons and entities until *the earlier of* either December 31, 2011, or 60 days after an applicable Title VII rulemaking becomes final. This exemption would *not* provide relief from provisions of Title VII that relate to futures contracts, options on futures, retail foreign exchange and other commodity transactions. It also would not affect anti-fraud provisions, rules already in effect and certain specific provisions with respect to instruments other than swaps. The SEC offered similar relief for security-based swaps as well (*see* entry under SEC below).

The CFTC has allowed 14 days for comment and then plans to adopt the order in the first week of July. The net effect of this action will be that Title VII swap provisions will become effective on July 16, but compliance with many provisions is delayed to permit completion of the

rulemaking process. The CFTC's goal in taking this action is to "ensure that current practices will not be unduly disrupted during the transition to the new regulatory regime."

The order seeks to address all Title VII provisions by dividing them into four categories based on their effective dates:

1. **Effective by Regulation.** Title VII provisions that expressly require rulemakings to become effective. No relief is needed and none is offered. Those provisions would become effective 60 days after final rulemakings appear, likely with phased compliance. Examples include registration of swap dealers and major swap participants (SD/MSPs), capital and margin rules, external business conduct rules for SD/MSPs).
2. **Effective on July 16 but Defined Terms Require Regulations.** Relief would be provided for "persons and entities" subject to Title VII

provisions that become effective on July 16, 2011, but specifically contain terms that require further definition.

3. Effective on July 16, No Defined Terms Requiring Regulation, But That Repeal Current Law. Relief proposed.

4. Effective on July 16, No Defined Terms Requiring Regulation. No relief proposed.

The proposed order addresses categories 2 and 3 only, based on the view that the first and fourth categories either do not become effective or do not merit relief. For this reason, the order refers to offering relief in “two parts.”

The key delay in compliance for the swap markets would arise from Category 2 relief, the first part of CFTC relief offered. Category 2 would provide exemptions from Title VII provisions that contain terms subject to further regulatory definition such as “swap,” “swap dealer,” “major swap participant,” and “eligible contract participant.” The rationale is that without final rulemakings, compliance is impossible and therefore relief makes sense.

In an effort to limit relief to swaps, the CFTC notes that Category 2 relief would “apply only with respect to those requirements or portions of such provisions that specifically relate to such referenced terms.” Therefore, if a Title VII provision references both swaps and futures, the exemption would apply to swaps only.

To help the market understand the scope of this exemptive order, the CFTC staff released lists of Dodd-Frank provisions that do not require exemption (Category 1) or are not receiving an exemption (Category 4). At the meeting, the CFTC staff said it hopes to receive feedback on whether these lists are complete and whether the order achieves the stated goal of allowing swap markets to continue to operate largely on a pre-Dodd-Frank basis.

The second part of the CFTC order continues to provide relief for portions of the derivatives market that would become regulated on July 16th due to repeal of existing law. Those provisions provide exemptions from regulation to “exempt” or “excluded commodities” and do not contain terms subject to further regulatory definition, unlike Category 2. Dodd-Frank repeals various provisions of the Commodity Exchange Act to subject certain energy, metal and financial swap agreements to regulation. Once those statutory provisions are effectively repealed, a CFTC regulation (Part 35) will continue to provide a narrow exemption for swaps in these categories if they are not standardized, cleared or exchange traded and are between “eligible swap participants.”

The proposed order would temporarily exempt any other affected transactions that do not qualify for the continued Part 35 exemption. An exemption is offered on a ‘but for’ basis, with conditions, by covering swap agreements that would meet the Part 35 exemption *but for* the fact that they are on exchange, cleared, not between eligible swap participants. A key condition would require one participant to this transaction to be entering it “in conjunction with its line of business” and it must not be marketed to the public.

The Title VII provisions that will become effective, without relief, include anti-fraud and anti-manipulation provisions, rules already in effect such as those regarding retaining and reporting data regarding historical swaps, and core principles for derivatives clearing organizations (“DCOs”) and designated contract markets. The CFTC specifically did not provide an exemption from the Title VII provisions that deem depository institutions and SEC registered clearing agencies to be registered as DCOs. It also withheld exemption from the Title VII provision that would provide a private right of action with respect to swaps.

EU Commissioner Michel Barnier Urges Coordination and Consistency in Financial Regulatory Reform

On June 3, 2011, EU Commissioner Michel Barnier, spoke at the Brookings Institute in Washington, D.C. Commissioner Barnier emphasized that in financial services regulation “technical details matter” which explains why he views it as important that dialogue continue between the US and EU on a “technical level.” Commissioner Barnier focused his remarks on four financial regulatory issues.

Derivatives

According to Commissioner Barnier, the first area for consistency is regulation of derivatives. In his words, “incoherence and inconsistency between our rules will have negative consequences for our markets. The financial system is by nature global. Differences could lead to global arbitrage. Trades may move where rules are laxer. This would put us all at risk.” He emphasized that consistency must be sought on important issues -- scope and conditions for clearing, collateral and capital requirements and the recognition of each other’s central counterparties and trade repositories. He rejected calls for delay in implementing derivatives reforms and noted EU concerns about extraterritorial impact, all the while stressing that “[e]quality and reciprocity are not only justified. They are also necessary.”

Basel

Commissioner Barnier also said the EU Commission will shortly adopt a Basel III proposal for all EU banks,

regardless of their size. To be precise, the EU will apply Basel to 8,232 banks compared to less than 20 in the US. He noted with some fervor that “[w]e must have a global level playing field. I can assure you that EU regulators will not accept a global regulatory race to the bottom.”

Accounting Standards

Although expressing confidence that the US “will deliver on its promise to bring true convergence in the area of financial reporting, he noted that the US and EU “have been working on this issue for a long time and the patience of Europe reaching its limits.”

Managing Failing Banks

Commissioner Barnier also said that this autumn, he will put forward a proposal to create a European framework to manage banking crises, which he viewed as perhaps the most important reform during his mandate as a European Commissioner.

Compensation

Finally, as a “small final point,” he expressed the hope to see change in the remuneration for bankers in the US, noting that “we in Europe are the only ones that have put binding rules on bonuses in place and that “[c]ertain [US] remuneration packages and bonuses are simply beyond our citizen’s comprehension. And mine.”

FDIC Establishes Advisory Committee on Systemic Resolutions

On June 3, 2011, the FDIC approved the creation of the FDIC Advisory Committee on Systemic Resolutions to “provide advice and guidance on a wide range of issues regarding the resolution of large, systemically important institutions.” The Committee was established in accordance with Title II of Dodd-Frank. According to the Committee’s charter, issues to be considered include:

- Effects on financial stability and economic conditions from a covered company’s failure and how they arise;

- Effects on markets and stakeholders of a covered company;
- Market understanding of the structures and tools available to the FDIC to facilitate an orderly resolution of a covered company;
- Application of such tools to nonbank financial entities;
- International coordination of planning and preparation for the resolution of internationally active companies; and

- Harmonization of resolution regime across international boundaries.

This Committee will only provide advice and recommendation and is not charged with any formal decision making authority and will not have access to non-public or confidential supervisory information. According to the charter, the Committee will meet as necessary (estimated to be at least twice a year) with the first meeting taking place on June 21, 2011, and will report to the FDIC Chairman.

Members of the Committee will include representatives from various financial, audit, accounting, credit rating,

GAO Report on Modified Prompt Corrective Action Framework

In June 2011, the Government Accountability Office (GAO) released its study of federal regulators' use of prompt corrective action (PCA) to identify and promptly address capital deficiencies at FDIC-insured depository institutions to minimize losses to the Deposit Insurance Fund (DIF). The GAO's report examines (1) the outcomes of regulators' use of PCA on the DIF; (2) the extent to which regulatory actions, PCA thresholds, and other financial indicators helped regulators address likely bank trouble or failure; and (3) options available to make PCA a more effective tool.

GAO analyzed agency and financial data to describe PCA and DIF trends and assess the timeliness of regulator actions and financial indicators. GAO also reviewed relevant literature and surveyed expert stakeholders from research, industry, and regulatory sectors on options to improve PCA.

GAO concluded that although the PCA framework has provided a mechanism to address financial deterioration in banks, its analysis suggests that the PCA regime "did not prevent widespread losses to the DIF—a key goal of PCA." Since 2008, the financial condition of banks has declined rapidly and use of PCA has grown tenfold. However, GAO found that every bank that underwent PCA because of capital deficiencies and failed in this period produced a loss to the DIF. Moreover, these losses were comparable as a percentage of assets to the losses of failed banks that did not undergo PCA. While

legal, and academic backgrounds. The number of members on the committee will not exceed 20 and members will serve terms not exceeding two years. The committee chairperson will be selected by the Board Chairman.

The initial members are an august group led by former Fed Chairman Paul Volcker, former SEC Chairman William Donaldson, former Citi CEO John Reed, and a number of prominent academics, banking lawyers, and bankruptcy and payment system experts among others.

regulators and others acknowledged PCA's limitations, regulators said that the PCA framework provides benefits, such as facilitating orderly closures and encouraging banks to increase capital levels.

Need for New PCA Triggers

In the GAO's view, the PCA's triggers limit the program's ability to promptly address bank problems, and although regulators had discretion to address problems sooner, they did not consistently do so. Since the 1990s, GAO and others have noted that the effectiveness of PCA, as currently constructed, is limited because of its reliance on capital, which can lag behind other indicators of bank health. That is, problems with the bank's assets, earnings, or management typically manifest before these problems affect bank capital.

Once a bank falls below PCA's capital standards, a bank may not be able to recover regardless of the regulatory action imposed. GAO tested other financial indicators, including measures of asset quality and liquidity, and found that they were important predictors of future bank failure. These indicators also better identified those institutions that failed and did not undergo the PCA process during the recent crisis. Although regulators identified problematic conditions among banks well before failure, the presence and timeliness of enforcement actions were inconsistent.

Possible Options

Most stakeholders (23 of 29) surveyed by GAO agreed that PCA should be modified and identified three top options to make it more effective. The first option—incorporating an institution’s risk profile into PCA capital categories—would add a measure of risk to the capital category thresholds beyond the existing risk-weighted asset component. The second option was increasing the capital ratios that place banks in PCA capital categories. The third most popular option was

including another trigger for PCA, such as asset quality or asset concentration. The GAO noted that each option has advantages and disadvantages. For example, while an additional trigger could account for other factors often found to precede capital deterioration, it might be difficult to implement. Although stakeholders supported these broad options, they cautioned that the manner in which any option was crafted would determine its success.

OCC and FDIC Release List of OTS Regulations Each Will Enforce

The Dodd-Frank Act transfers the OTS’s supervisory functions to the OCC and to the FDIC for federal and state savings associations, respectively, on July 21, 2011. The transfer of regulations to the FDIC and OCC (collectively, the Agencies) does not currently have a substantive effect on the regulations at issue. The notice is intended to provide a reference for federal and savings associations to their new respective regulatory authorities. The Agencies are expected to issue final rules to clarify and codify the rules and regulations.

including the possibility for more significant adjustments or rescission of OTS regulations. Additionally, for certain rules, the FDIC does not have rulemaking authority for rules it is responsible for enforcing. An example is the Community Reinvestment Act (CRA) for state associations, Section 358 of the Act requires the OCC to have rulemaking authority over CRA for both state and federal associations, but requires the FDIC to enforce the rule for state associations. This may cause challenges for state associations as FDIC input should be considered when the OCC is drafting or modifying rules without institution specific knowledge developed during the supervisory process.

In addition to a new supervisory authority, federal and state savings associations should be prepared for minor modifications in current regulations by the transfer date,

OCC Issues Proposed Guidance on Deposit-Related Consumer Credit Products

On June 8, 2011, the Office of the Comptroller of the Currency (OCC) proposed supervisory guidance to clarify the application of principles on safe and sound banking practices in connection with deposit-related credit products (*i.e.*, overdraft protection and direct deposit advance programs).

operational, reputational, compliance and credit risks. The supervisory principles include the following:

Through its supervisory process, the OCC found that a small percentage of institutions were not fully considering the risks associated with deposit related credit products. The proposed supervisory guidance details the principles that the OCC expects national banks to follow in connection with any deposit-related consumer credit product to address potential

- *Disclosure.* Prior to customer enrollment into a deposit-related credit product, “clear and conspicuous” disclosure of product costs, terms, and material limitations should be provided. Additionally, the bank should provide information on alternative products, if applicable, offered by the bank.
- *Legal Compliance.* The product must comply with the Federal Trade Commission Act’s prohibition against unfair and deceptive practices and other applicable laws and regulations.

- *Affirmative Request.* The customer should affirmatively accept the product terms and conditions after applicable disclosures have been provided. The bank should not automatically enroll the customer into a deposit-related credit product. Further, the bank should have sufficient information about the customer to ensure they meet the bank's eligibility standards. The bank's marketing materials may not mislead customers about the optional use of the product.
- *Program Eligibility and Prudent Eligibility Standards.* The bank should have policies and procedures clearly identifying eligibility criteria for customers to obtain a deposit related credit product. Further, an "appropriate degree of analysis" should be conducted prior to enrolling the customer into the product to determine if the customer will be able to handle and repay the obligation.
- *Prudent Limitations on Product Costs and Usage.* Fees should be based on prudent safety and soundness principles. Product revenue should be continuously monitored to prevent over-reliance on a single products revenue stream.
- *Monitoring and Risk Assessments.* Revenue and volume of customer usage should be specifically monitored to identify risks. If excessive usage or nonperformance is identified, the principles require appropriate action.
- *Management Oversight.* Management should receive and review product usage reports, fee income, legal compliance, conducting periodic audits, and by monitoring of third party vendors.
- *Account Management and Charge offs.* Applicable guidelines should be followed.

In Appendix A of the proposal, the OCC updated and expanded the 2005 "Joint Agency Guidance on Overdraft Protection Programs," to describe how OCC will apply the safety and soundness principles applicable to deposit-related consumer credit products to overdraft protection. Key updates to the 2005 Guidance include:

- *Product Availability and Prudent Eligibility Standards.* National banks should adopt policies and procedures concerning the availability of overdraft protection that set forth eligibility criteria that must

be met by a depositor to obtain automated overdraft protection. Those policies and procedures should provide a bank should receive affirmative consent from new customers on those overdraft programs not covered by Regulation E's overdraft rules (*i.e.* checks). Further, prudential criteria for enrolling a customer in overdraft protection program should include an initial risk assessment should be performed of the customer's overdraft account privileges.

- *Disclosures.* Initial account disclosures should include the order of processing transactions and the fact that the order can affect the total amount of overdraft fees incurred by the customer.
- *Prudent Limitations.* National banks should establish prudent programmatic limitations on the amount of credit that may be extended under and overdraft protection program, the number of overdrafts and the total amount of fees that may be imposed per day and per month, and any transaction amount below which an overdraft fee will not be imposed. Also, the transaction posting order should be evaluated to ensure it is not solely designed to maximize overdraft fee income.
- *Management Oversight.* Banks should receive regular reports on overdraft volume, profitability, and credit performance.
- *Chargeoffs.* Overdraft protection should be suspended or terminated when the customer no longer meets eligibility criteria, has declared bankruptcy, or is in default on repayment of an overdraft or on any other loan with the bank.

Appendix B of the proposal provides a description of how the OCC will apply safety and soundness principles applicable to deposit advance products. Key guidelines from the appendix include:

- *Product Availability and Prudent Eligibility Standards.* National Banks should implement policies and procedures that set forth eligibility criteria for deposit advance products and provide customers with the right to "opt-in" to the program. Additionally, the customer should have the option to "opt-out" of the program at any time.



- *Disclosures.* Customers should receive clear and conspicuous disclosure - before becoming enrolled - of the product's terms and conditions including: descriptions of fees, costs, and any program limitations; explanation that direct deposit programs can be costly and information on other programs; explain the transaction posting process of credit advance repayment; explain how the loan must be repaid if the deposit is insufficient; and description of key program features.
- *Prudent Limitations.* National Banks should be established to take into account customer's recurring direct deposit history, the need for a portion of the direct deposit to remain available for daily expenses, account usage, and other credit extended to the customer. The limits include: the number of periods of back to back transfers before a "cooling off period"; number of months in which advances can

be outstanding; total amount or percentage of advance each period; total amount or percentage of any deposit that may be used for repayment.

- *Repayment Terms.* Deposit advances should be permitted to be repaid by direct deposits or separate payment in advance of the date a deposit would be debited without any additional fee. National banks should not allow repayment of advances that would overdraw the account or permit additional advances.

The proposed guidance will require banks to continuously evaluate deposit customer's ability to repay the costs of a deposit-related credit product and require more detailed product disclosures. The current terms of the proposal will impact account origination processes, policies, procedures, training, management oversight, and the compliance monitoring/reporting functions. Comments on the proposal are due to the OCC by July 8, 2011.

OCC Proposed Rules on Supervision of Thrifts Subject to OTS Supervision

On May 26, 2011, the Office of the Comptroller of the Currency (OCC) proposed a rule to implement the transfer of functions from the Office of Thrift Supervision (OTS) to OCC beginning July 21, 2011, and changes to the OCC's preemption and visitorial authority. The proposed rule also would amend the OCC's rules regarding agency functions and operations, including assessment fees imposed on supervised institutions. Thrifts will be subject to a transitional assessment fee schedule, under which the OCC will compute assessment fees under both the OCC and OTS schedules for assessments charged in September 2011, and March 2012, and thrifts will pay the lesser of the two fees. A single fee schedule will become effective in September 2011, for all banks under the OCC's supervision.

The proposal also includes changes to the OCC's regulations necessary to implement certain revisions to the banking laws that took effect on the enactment of the Dodd-Frank Act, including revisions to the OCC's change in control rules to implement the moratorium on certain changes in control of credit card banks and trust banks and revisions to reflect the permanent increase in deposit insurance coverage applicable to the few FDIC-insured Federal branches of foreign banks. In addition,

the proposal includes amendments to OCC rules pertaining to preemption and visitorial powers, including:

- Elimination of preemption for national bank operating subsidiaries;
- Application of preemption standards and visitorial powers standards for national banks to federal thrifts and their subsidiaries – meaning federal thrifts lose "filed" preemption and will be subject to the same preemption rules as national banks; and
- Revision of the OCC's visitorial powers rule to conform to the Supreme Court's *Cuomo* decision, recognizing the ability of state attorneys general to bring enforcement actions in court to enforce non-preempted state laws against national banks.

The comment period closed on June 27, 2011. As part of its integration of OTS functions, the OCC also plans to issue an Interim Final Rule for comment that republishes OTS regulations that the OCC will have authority to enforce upon transfer of supervisory authority. The rules will be renumbered and issued as new OCC rules, including technical amendments required to reflect the OCC's supervision of Federal thrifts.



SEC Adopts New Whistleblower Rule

On May 25, 2011, the SEC adopted final rules establishing a whistleblower program. The final rules implement Section 922 of the Dodd-Frank Act (Dodd-Frank or the Act), which authorizes the SEC to pay rewards to individuals who provide the SEC with original information that leads to successful SEC enforcement actions and certain related actions. The final rules become effective on August 12, 2011.

The Whistleblower Rules are on a short list of the most contentious rules to emerge from Dodd-Frank. Concerns have been expressed by corporate America that they would undermine companies' internal compliance programs – a point reinforced by Commissioner Kathleen Casey in voting against the rules. The new rules, like other corporate changes in Dodd-Frank, are more about corporate reform than the financial crisis and will impact a broad range of entities including public companies and their subsidiaries and affiliates, broker-dealers, investment advisers, investment companies, rating agencies, and private funds. Lastly, is the concern that the play-to-get-paid feature will lead to a significant increase in Whistleblower activity and litigation. The SEC has said that it expects to receive approximately 30,000 tips per year and plaintiffs' law firms have set up websites to attract Whistleblower leads in the United States and abroad. The following are some highlights:

Who Can Be a Whistleblower?

The question is “who” because a Whistleblower must be an individual (alone or jointly with others); a company or similar entity is not eligible. A Whistleblower must *voluntarily provide* the SEC with *original information* that relates to a possible violation of the federal securities laws that has occurred, is ongoing, or is about to occur. If, before providing the information, the Whistleblower received a request, inquiry or demand from the SEC or other legal authorities for the information, including Congress, any information provided is not voluntary. Thus, if the Whistleblower received a request relating to possible insider trading, the Whistleblower cannot profit. The information must also be original knowledge or the result of independent

analysis – if the Whistleblower discovers a Ponzi scheme on their own analysis they can still report it to the SEC, unless it is already known to the SEC.

Information that Leads to Successful Enforcement

To qualify for an award, a Whistleblower's information must “lead to” the successful enforcement by the SEC of a federal court or administrative action in which the agency obtains monetary sanctions totaling more than \$1 million. The Whistleblower is entitled to an award between 10% and 30% of the aggregate recovery. To meet this “lead to” test, the information must have been sufficiently specific to cause staff to open or reopen an investigation. The rules also allow the Whistleblower to benefit if he or she reported the information through a company's internal legal or compliance reporting procedures before or at the same time it is reported to the SEC and the company reports the information to the SEC.

Persons Generally Excluded from Eligibility for Awards

Certain individuals generally will not be eligible for awards under the final rules, including:

- People who have a pre-existing legal or contractual duty to report their information to the SEC;
- Attorneys (including in-house counsel) who attempt to use information obtained from client engagements to make Whistleblower claims for themselves (unless disclosure of the information is permitted under SEC rules or state bar rules);
- Officers, directors, trustees or partners of an entity who are informed by another person of allegations of misconduct, or learned the information in connection with the entity's processes for identifying, reporting and addressing possible violations of law;
- Compliance or audit personnel;
- Public accountants working on an engagement under federal securities laws, if the engagement relates to a violation by the engagement client; and

- People who obtain the information by means or in a manner that is determined by a US. Court to violate federal or state criminal law, and foreign government officials.

In certain instances compliance and internal audit personnel, as well as public accountants, could become Whistleblowers, such as when:

- The Whistleblower has a reasonable basis to believe that disclosure of the information to the SEC is necessary to prevent the relevant entity from engaging in conduct that is likely to cause substantial injury to the financial interest or property of the entity or investors;
- The Whistleblower has a reasonable basis to believe that the relevant entity is engaging in conduct that will impede an investigation of the misconduct;
- At least 120 days have elapsed since the Whistleblower provided the information to the relevant entity's audit committee, chief legal officer, chief compliance officer; or
- 120 days have elapsed since the Whistleblower received the information, if the Whistleblower received it under circumstances indicating that these people were already aware of the information.

Internal Compliance

The final rules do not require Whistleblowers to first report information to corporate compliance programs before reporting to the SEC in order to qualify for an award. However, the SEC included several provisions that it believes will incentivize Whistleblowers to first report internally:

- Whistleblowers who first report internally to company compliance programs are eligible to receive an award from the SEC if they report the same information to the agency within 120 days (this is an extension from the 90 day period provided in the proposed rule).
- A Whistleblower's voluntary participation in a company's internal compliance program may increase the amount of an award; interference with the compliance program may decrease the amount of an award.

- A Whistleblower may also be eligible to receive an award if the whistleblower first reports information to his company's internal compliance program and the company then reports the information to the SEC. The information submitted by the company will be credited to the whistleblower even if he did not report it to the SEC.

Providing Information and Seeking a Reward

The final rules set forth procedures for submitting information to the SEC and for making a claim for an award after an action is brought. The claim procedures provide for opportunities for Whistleblowers to fairly present their claim before the SEC makes a final award determination. The SEC will also pay an award based on amounts collected in related actions brought by certain agencies that are based upon the same original information that led to a successful SEC action.

Anti-Retaliation Provisions

Under the final rules, a Whistleblower who provides information to the SEC is protected from employment retaliation if he possesses a reasonable belief that the information he is providing relates to a possible securities law violation that has occurred, is ongoing, or is about to occur. The retaliation protections apply to a whistleblower regardless of whether or not he or she ultimately meets the requirements to qualify for an award.

Confidentiality of Submissions

The SEC may not disclose information that could reasonably be expected to reveal the identity of a Whistleblower, except in certain circumstances. The rules provide that a Whistleblower may submit information to the SEC anonymously. However, the Whistleblower must also:

- Have an attorney represent him in connection with the submission of information and claim for an award;
- Follow procedures for submitting original information anonymously; and
- Disclose his/her identity to the SEC and must be verified by the SEC before the SEC will pay any reward.



SEC Adopts Private Fund Adviser Registration and Other Investment Advisor Rules

On June 22, 2011, the Securities and Exchange Commission (SEC) approved three sets of final regulations for investment advisers that implement amendment to the Investment Advisers Act of 1940 contained (Advisers Act) made by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). One set of rules will require advisers to private funds, or hedge funds, to register with the SEC by March 30, 2012. Another will establish new exemptions from SEC registration, but not reporting, for three narrow classes of advisers and will reallocate regulatory responsibility for advisers between the SEC and the states. The third rulemaking will define “family office” under the Advisers Act and sets out conditions for family offices to continue to be exempt from registration. Many of these changes become effective on July 21, 2011, and registration generally is required by March 30, 2012. Following is a summary of these new rules.

Private Fund Regulation and Exemptions

Section 403 of Dodd-Frank repealed the “private adviser exemption” contained in Section 203(b)(3) of the Advisers Act which has shielded certain investment advisers from registration with, and regulation by, the SEC. Many private fund advisers will have to register with the SEC for the first time, unless they qualify for one of the three new exemptions from registration provided for certain foreign advisers, advisers to venture capital funds and advisers solely to small private funds. The Act also reallocated regulatory responsibility for certain mid-sized advisers to state securities regulatory authorities, in recognition of the SEC’s limited examination resources.

The new investment adviser registration rules will, among other things:

- Require non-exempt advisers to private funds to register with the SEC by March 30, 2012;
- Mandate reporting for exempt investment advisers;
- Increase the statutory threshold for registration of investment advisers with the SEC to \$100 million; and

- Amend the Pay-to-Play Rule.

Registration

Under the new rule, advisers to private funds will be subject to the same registration requirements, regulatory oversight, and other requirements that apply to other SEC-registered investment advisers. Registration must be submitted by March 30, 2012, on Form ADV.

Exempt Advisers

Investment advisers to the following types of funds do not have to register with the SEC:

- Advisers solely to venture capital funds,
- Advisers solely to private funds with less than \$150 million in assets under management in the United States, and
- Certain foreign advisers without a place of business in the United States.

These rules become effective on July 21, 2011.

Exempt Advisers to Venture Capital Funds

The exemption would be provided to advisers to any venture capital fund that meets the definition of a private fund and:

- Invests primarily in “qualifying investments” (generally, private operating companies that do not distribute proceeds from debt financings in exchange for the fund’s investment in the company), but may invest in a “basket” of non qualifying investments of up to 20 percent of its committed capital and may hold certain short-term investments.
- Is not leveraged except for a minimal amount on a short-term basis.
- Does not offer redemption rights to its investors.
- Represents itself to investors as pursuing a venture capital strategy.
- Is not registered under the Investment Company Act and has not elected to be treated as a business development company.



Under a grandfathering provision, funds that began raising capital by the end of 2010 and represented themselves as pursuing a venture capital strategy would generally be considered venture capital funds.

Exempt Private Fund Advisers with Less than \$150 Million in Assets under Management in United States

An adviser may serve an unlimited number of private funds without registering, if the aggregate value of the assets of its advised private funds is less than \$150 million. In the case of an adviser with a principal office and place of business outside of the United States (non-US adviser), the exemption is available as long as all of the adviser's clients that are US persons are qualifying private funds. As a consequence, a non-US adviser may enter the US market and take advantage of the exemption without regard to the type or number of its non-US clients or the amount of assets it manages outside of the United States.

Exempt Foreign Private Advisers

An exemption from registration is available for foreign advisers that:

- Do not have a place of business in the United States;
- Have less than \$25 million in aggregate assets under management attributable to US clients and private fund investors;
- Have fewer than 15 US clients and private fund investors; and
- Do not hold themselves out generally to the public in the United States.

Reporting and Amendments to Form ADV

To enhance its ability to oversee investment advisers to private funds, the SEC is requiring investment advisers to provide additional information about the private funds they manage. Under an amended adviser registration Form ADV, advisers to private funds will have to provide, among other things:

- Basic organizational and operational information about each fund they manage, such as the type of private fund (*e.g.*, hedge fund, private equity fund, or liquidity fund), general information about the size

and ownership of the fund, general fund data, and the adviser's services to the fund.

- Identification of five categories of "gatekeepers" that perform critical roles for advisers and the private funds they manage (*i.e.*, auditors, prime brokers, custodians, administrators and marketers).

These reporting requirements are designed to help identify practices that may harm investors, deter fraud, and facilitate earlier discovery of potential misconduct. This information will provide for the first time a "census" of this important area of the asset management industry.

Registered investment advisers will have to provide additional information on Form ADV that includes: (i) types of clients, (ii) their employees, (iii) their advisory activities, and (iv) any business practices that may present significant conflicts of interest (such as the use of affiliated brokers, soft dollar arrangements and compensation for client referrals). The rules also will require advisers to provide additional information about their non advisory activities and their financial industry affiliations.

Exempt Adviser Reporting Requirements

Exempt reporting advisers will be required to file, and periodically update, reports with the SEC, on Form ADV. However, exempt reporting advisers will fill out only a limited subset of items on the form, including:

- Basic identifying information for the adviser and the identity of its owners and affiliates.
- Information about the private funds the adviser manages and about other business activities that the adviser and its affiliates are engaged in that present conflicts of interest that may suggest significant risk to clients.
- The disciplinary history (if any) of the adviser and its employees that may reflect on the integrity of the firm.

Exempt advisers will file reports on the SEC's investment adviser electronic filing system, and these reports will be publicly available on the SEC's website. These advisers will be required to file their first reports in the first quarter of 2012.



Reallocation of Regulatory Responsibility

A new category of adviser called a “mid-sized advisers” generally may not register with the SEC and will be subject to state registration. A mid-size adviser is an adviser that: (i) manages between \$25 million and \$100 million for its clients, (ii) is required to be registered in the state where it maintains its principal office and place of business, and (iii) would be subject to examination by that state, if required to register.

The SEC estimates that approximately 3,200 of the current 11,500 registered advisers will switch from SEC registration to state registration. These advisers will continue to be subject to the Advisers Act’s general anti-fraud provisions.

Pay-to-Play Rule Amendments

The amendments to the investment adviser “pay to play” rule effect will make several changes. First, the existing pay to play rule will apply to exempt reporting advisers and foreign private advisers. Municipal advisors are added to the categories of registered entities excepted from the rule’s prohibition on advisers paying third parties to solicit government entities. Last, an adviser will be permitted to pay a registered municipal advisor to act as a placement agent to solicit government entities on its behalf, if the municipal advisor is subject to a pay-to-play rule adopted by the Municipal Securities Rulemaking Board (MSRB) that is at least as stringent as and consistent with the objectives of the investment adviser pay to play rule.

The SEC extended the date by which advisers must comply with the ban on third-party solicitation from September 13, 2011 to June 13, 2012 to allow time for the MSRB and FINRA to adopt pay to play rules if they choose to do so, and give third party solicitors additional time to come into compliance with the rules.

Family Offices

Historically, many family offices that did not qualify for the old private adviser exemption obtained orders of exemption from the SEC declaring those offices not to be investment advisers. Recognizing this past practice, Section 409 of Dodd-Frank requires any family office definition that the SEC adopts to be consistent with previous exemptive policy and recognize “the range of organizational, management and employment structures and arrangements employed by family offices.”

Under the final rule, family office will be exempt from the definition of an investment adviser under the Advisers Act and thus not subject to registration with the SEC if it: (i) provides investment advice only to “family clients,” as defined in the rule; (ii) is wholly owned by family clients and is exclusively controlled by family members and/or family entities; and (iii) does not hold itself out to the public as an investment adviser.

The rule also incorporates a “grandfathering” provision that provides the definition of family office will not exclude any person, who was not registered or required to be registered under the Advisers Act on January 1, 2010, based on enumerated conditions.

Family offices that do not meet the terms of the exclusion will have to register with the SEC or with applicable state regulatory authorities by March 30, 2012. Any company existing on July 21, 2011 that would qualify as a family office but for it having as a client one or more non-profit organizations, charitable foundations, charitable trusts, or other charitable organizations that have received funding from one or more individuals or companies that are not family clients will have until December 31, 2013 to comply with the terms of the exclusion.

SEC Announces Steps to Address One-Year Effective Date of Dodd-Frank

On June 10, 2011, the Securities and Exchange Commission announced a series of actions to clarify the requirements that will apply to security-based swap transactions as of July 16—the effective date of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act—and to provide appropriate temporary relief.

The SEC plans to:

1. Provide guidance regarding which provisions of Subtitle B of Title VII will become operable as of July 16, and, where appropriate, provide temporary relief from several of these provisions.
2. Provide guidance regarding—and where appropriate, temporary relief from—the various pre-Dodd-Frank provisions of the Exchange Act that would otherwise apply to security-based swaps on July 16. Under Dodd-Frank, security-based swaps would be included in the definition of “security” under the Exchange Act. While such swaps will be subject to provisions addressing fraud and manipulation, the

Commission intends to provide temporary relief from certain other provisions of the Exchange Act so that the industry will have time to seek, and the Commission can consider, what if any further guidance or action is required.

3. Take other actions such as extending existing temporary rules under the Securities Act, the Exchange Act, and the Trust Indenture Act, and extending existing temporary relief from exchange registration under the Exchange Act. This will help to continue facilitating the clearing of certain credit default swaps by clearing agencies functioning as central counterparties.

After proposing all of the key rules under Title VII, the SEC intends to consider publishing a detailed implementation plan in order to enable the SEC to move forward expeditiously with the roll-out of the new securities-based swap requirements in the most efficient manner, while minimizing unnecessary disruption and costs to the markets.

SEC Provides Temporary Relief from Regulation of Security-Based Swaps

On June 15, 2011, the SEC issued an order that provides guidance as to which of the Title VII requirements will apply to security-based swap transactions as of July 16th and granted temporary relief to market participants from compliance with certain of those requirements. While the SEC’s approach to providing relief is not identical to the CFTC’s, it is similar in effect.

The SEC first identifies several types of provisions of Title VII which, in its view, require no relief from the looming Dodd-Frank effective date. These include:

- Provisions requiring rulemaking which will not be effective until such at least 60 days following publication of final rules;
- Provisions that apply to registered persons and will not be effective until final and effective rules regarding registration are in place (for example,

capital, margin, reporting and recordkeeping requirements);

- Provisions imposing requirements that require compliance by market participants as a result of SEC action and that will not be effective until the SEC takes such action;
- Provisions that authorize or direct the SEC to take specified action imposing compliance obligations on market participants and that will not be effective until the SEC takes such action (for example, statutory provisions requiring the SEC to prescribe rules governing the regulation of securities-based swap execution facilities).

With this template in place, the SEC evaluates specific provisions of the Dodd-Frank Act by subject matter area. In a series of tables—concerning clearing, SB swap execution facilities, segregation of collateral, anti-fraud

provisions, position limits, reporting, registration and regulation of security-based swap dealers and major security-based swap participants and registration of clearing agencies—the SEC lists particular Dodd-Frank provisions, identifies those provisions with which compliance will be required on the effective date of the legislation, and those with which compliance will be triggered only by registration, final rules or other SEC action. For those provisions requiring compliance by the effective date, the tables indicate whether temporary relief is granted and the duration of such relief.

The SEC's analysis indicates that many provisions of the Dodd-Frank Act related to SBS simply do not require relief from the July 16th effective date because they cannot be effective until a rule is drafted or other action taken. For example, with regard to provisions applicable to security based swap execution facilities, the SEC states that no relief is required for provisions concerning trading and trade processing and compliance with core

principles (because registration is a prerequisite), but that relief from registration requirements themselves is necessary (because currently operating alternative trading systems may qualify as security based swap facilities but be unable to register). Ultimately, this guidance makes clear that substantially all of Title VII's requirements applicable to SBS (and compliance with most of them) will not go into effect on July 16 either because they cannot or because the SEC has granted temporary relief.

In addition, the SEC order provides temporary relief from Section 29(b), which generally provides that contracts made in violation of any provision of the Exchange Act shall be void as to the rights of any person who is in violation of the provision. However, antifraud and anti-manipulation prohibitions of the federal securities laws will continue to apply to SBS after July 16.

SEC Issues Final Rule on Beneficial Ownership Reporting Requirements and Security-Based Swaps

On June 10, 2011, the SEC readopted without change the relevant portions of Rules 13d-3 and 16a-1 to preserve the application of existing beneficial ownership rules to persons who purchase or sell security-based swaps after new Section 13(o) of the Securities Exchange Act of 1934 becomes effective on July 16, 2011. Section 13(o) provides that a person shall be deemed a beneficial owner of an equity security based on the purchase or sale of a security-based swap only to the extent we adopt rules after making certain determinations with respect to the purchase or sale of security-based swaps. The SEC confirmed that, after July 16, 2011, persons who purchase or sell security-based swaps will remain within the scope of these rules to the same extent as they are now.

Section 766 of the Dodd-Frank Act amends the Exchange Act by adding Section 13(o), which provides that “[f]or purposes of this section and section 16, a person shall be deemed to acquire beneficial ownership of an equity security based on the purchase or sale of a security-based swap, only to the extent that the Commission, by rule, determines after consultation with the prudential regulators and the Secretary of the Treasury, that the purchase or sale of the security-based swap, or class of security-based swap, provides incidents of ownership comparable to direct ownership of the equity security, and that it is necessary to achieve the purposes of this section that the purchase or sale of the security-based swaps, or class of security-based swap, be deemed the acquisition of beneficial ownership of the equity security.”

SEC Proposes Exemptions from Registration Requirement for Security-Based Swaps Issued by Clearing Agencies

On June 10, 2011, the SEC proposed rules that would provide certain clearing agencies with exemptions from the registration requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934 for security-based swaps (SBS) that they issue. This would facilitate the clearing of such SBS.

Specifically, the proposed rules would exempt transactions by clearing agencies in SBS from all provisions of the Securities Act, other than the Section 17(a) anti-fraud provisions, as well as exempt these security-based swaps from Exchange Act registration requirements and from the provisions of the Trust Indenture Act, provided certain conditions are met.

This builds on previous SEC decisions to facilitate clearing of certain credit default swaps by clearing agencies functioning as central counterparties. For example, the SEC previously adopted temporary rules that would exempt credit default swaps from these same registration and qualification requirements. The new proposed rules would create permanent exemptions that would cover these credit default swaps and the security-based swaps brought in through the Dodd-Frank Act.

Public comments on the proposed rules should be received by July 25, 2011.

Senate “Stop and Study” FRB Interchange Amendment Fails

On June 8, 2011, the Senate voted against an amendment to stop and study the Federal Reserve Board’s (FRB’s) proposed rule concerning Regulation II “Debit-Card Interchange Fees and Routing” (interchange fee standards). The FRB proposed the interchange fee standards on December 16, 2010, in response to section 1075 of the Dodd-Frank Act. This section requires the FRB to establish standards for assessing whether the amount of any debit interchange fee received or charged by an issuer with respect to an electronic debit transaction is reasonable and proportional to the

transactions’ cost of the issuer. The FRB was to adopt final interchange fee standards by April 21, 2011; however, due to the proposal’s significant impact on the financial services industry and number of comment letters the FRB received in response to the proposal, adoption of final rules has been postponed. Final standards are currently set to be released by July 21, 2011 and the failure of the stop and study amendment raises the likelihood of final rules to be released by the deadline.

Treasury Secretary Geithner Addresses Challenges to Completing Financial Reforms – Urges International Margin Standard for Uncleared Derivatives

On June 6, 2011, Treasury Secretary Tim Geithner addressed attendees at the International Monetary Conference to urge completion of financial regulatory reform in the US and ensure a level playing field globally. The Secretary began by noting the many positive developments since the financial crisis.

- The weakest parts of the US financial system—the firms that took the most risk—no longer exist or have been significantly restructured. Of the 15

largest financial institutions in the US before the crisis, only nine remain as independent entities.

- Those that survived did so because they were able to raise capital from private investors. Regulatory stress tests gave the private market the ability—through unprecedented disclosure requirements and clear targets for how much capital these institutions needed—to distinguish between those institutions that needed to strengthen their capital base and those that did not. The 19 firms put through that

process have together increased common equity by more than \$300 billion since 2008. The average level of common equity to risk weighted assets across these institutions is now 10 percent and the average total leverage in these institutions has fallen from \$16 of assets for every dollar of common equity to \$11.

- The risk in the so-called “shadow banking system”—the financial firms that operated outside of the protections and constraints imposed on banks—has fallen substantially. Assets in the “shadow banking system” are roughly half the level seen in 2007.

Open Questions under Basel III

Secretary Geithner noted that foremost among the many challenges of reform ahead are those that relate “to capital or leverage requirements and derivatives. It is on these two pillars that the prospect of a truly level global playing field most squarely rests.” Commenting on Basel III, he said decisions remained in three important areas:

- First, is the question of the size of the additional requirements to be imposed on the largest institutions which are commonly referred to as the “systemic surcharge.” In deciding on the amount, Secretary Geithner noted the need to consider the impact of other reforms that reduce both the probability of failure of large institutions and the ability of the rest of the financial system to absorb or contain or diffuse those losses.
- Secondly, is to distinguish between what all countries commit to require as a minimum, and what measures some countries may choose to have the discretion to impose on top of the systemic surcharge. In the US, the Secretary stated the largest US firms will hold an additional surcharge of common equity. Given the other protections

available in the US, including the orderly resolution authority, “we do not need to impose on top of that requirement any of the three other proposed forms of additional capital – convertible, bail in, contingent capital instruments, or counter cyclical capital requirements.”

- Thirdly, the US needs to make sure that it provides a much stronger set of protections to ensure a level playing field in the application of the new Basel III requirements and the additional systemic surcharge

Derivatives Regulation – Where Work Remains

On derivatives regulation, the Secretary indicated that “[a]lignment with Europe and Asia is essential.” The Secretary noted that the focus of remaining work with European counterparts “lies in a few key areas: scope of standardized derivatives contracts, central clearing and mandatory trading of standardized derivatives contracts, fair and open access to qualified participants for central counterparties of swaps, electronic trading platforms, reporting to data repositories, the scope of any exceptions or exemptions—for example, end-user exemptions and intra-group exemptions—and, finally, capital and margin requirements.”

In working with international counterparts on this range of issues, the Secretary said there is a need to develop “a global margin standard.” Just as there is a global minimum standard for bank capital—expressed in a tangible international agreement—we need global minimum standards for margins on uncleared derivatives trades. Without international consensus, the broader cause of central clearing will be undermined.” In the Secretary’s view, a global approach to margin will help prevent regulatory arbitrage and a race to the bottom. It will make the global financial system safer and stronger.

Additional Information

If you would like additional information about the topics discussed in this newsletter, or about PwC's Financial Services Regulatory practice, please call:

David Albright, Principal	703 918 1364	McLean, VA	david.albright@us.pwc.com
Thomas Biolsi, Principal	646 471 2056	New York, NY	thomas.biolsi@us.pwc.com
Emanuel Bulone, Partner	646 471 5131	New York, NY	emanuel.bulone@us.pwc.com
John Campbell, Principal	646 471 7120	New York, NY	john.w.campbell@us.pwc.com
Jeff Lavine, Partner	703 918 1379	McLean, VA	jeff.lavine@us.pwc.com
Gary Meltzer, Partner	646 471 8763	New York, NY	gary.c.meltzer@us.pwc.com
Graham O'Connell, Partner	646 471 2547	New York, NY	graham.oconnell@us.pwc.com
Ric Pace, Principal	703 918 1385	McLean, VA	ric.pace@us.pwc.com
Lori Richards, Principal	703 610 7513	McLean, VA	lori.richards@us.pwc.com
Daniel Ryan, Partner	646 471 8488	New York, NY	daniel.ryan@us.pwc.com
David Sapin, Principal	703 918 1391	McLean, VA	david.sapin@us.pwc.com
Thomas Sullivan, Principal	860 241 7209	Hartford, CT	thomas.sullivan@us.pwc.com
Ellen Walsh, Principal	646 471 7274	New York, NY	ellen.walsh@us.pwc.com
Dan Weiss, Principal	703 918 1431	McLean, VA	dan.weiss@us.pwc.com
Kenneth Albertazzi, Managing Director	617 530 6237	Boston, MA	kenneth.albertazzi@us.pwc.com
Anthony Conte, Managing Director	646 471 2898	New York, NY	anthony.conte@us.pwc.com
Richard Neiman, Managing Director	646 471 3823	New York, NY	richard.neiman@us.pwc.com
Robert Nisi, Managing Director	415 498 7169	San Francisco, CA	robert.nisi@us.pwc.com
Douglas Roeder, Managing Director	703 918 3492	McLean, VA	douglas.w.roeder@us.pwc.com
Gary Welsh, Managing Director	703 918 1432	McLean, VA	gary.welsh@us.pwc.com

www.pwcregulatory.com

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PricewaterhouseCoopers, LLP, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2011 PricewaterhouseCoopers, LLP. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers, LLP which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.

