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U.S. SENATE REPUBLICAN POLICY COMMITTEE

Legislative Notice

No. 36 April 26, 2010

S. 3217 – Restoring American Financial Stability Act of 2010

Calendar No. 349

S. 3217 was introduced on April 15, 2010, without written report and placed on the Senate Calendar.

Noteworthy

- Today at 5:00 p.m., the Senate will vote on a motion to invoke cloture on the motion to proceed to S. 3217.
- This document summarizes the bill as introduced.
- It is expected that Majority Leader Reid, or his designee, will add provisions relating to derivatives as developed by Senator Lincoln and reported by the Senate Agriculture Committee on April 22, 2010. It is unclear whether this addition will come in the form of a manager's amendment for the entire bill, incorporating the Lincoln provisions, or as a stand-alone amendment.
- As currently drafted, S. 3217 represents a partisan document prepared by Senate Democrats approved without Republican support.
- No written report was filed on the bill; however, on April 22, 2010, the committee made bill report language available on its Web site.

Background

A multitude of factors led to the development of what some are calling the Great Recession of 2008-2009[1] and the current financial crisis, which is ongoing for many Americans as

[1] "The Great Recession," by Chris Isidore, CNNMoney.com, March 25, 2009, http://money.cnn.com/2009/03/25/news/economy/depression_comparisons/index.htm

unemployment rates remain elevated.[2] It is worth noting that financial regulatory reform legislation is being brought to the floor before the Financial Crisis Inquiry Commission,[3] which established by Congress last year to examine the causes of the crisis, [4] has reported back its findings and recommendations. The Commission's report is due by the end of the year.[5]

Outlined below are some of the key issues and their roles in the current financial crisis.[6]

A. Housing Bubble – Leading into the financial crisis, arguments have been made that access to cheap credit and the positive image of homeownership encouraged many Americans to purchase homes, upgrade to larger homes, remodel and expand their existing homes, and purchase second homes as investment opportunities.[7] In some cases, this resulted in many prospective homeowners exceeding their capacity to borrow, including providing false or misleading information about income and assets in their mortgage applications in order to get loans approved. In other cases, lenders were more than happy to meet loan demand by lowering their lending standards to approve less-than-creditworthy applicants, increasing the offerings of non-traditional mortgages (e.g., adjustable rate mortgages), and relaxing applications standards to require little to no supporting documentation.

   Related organizations in the housing industry—which includes loan servicers, home builders, real estate agents, retailers, and local tax collectors—also had financial incentives to push homeownership as it generated increased fees and revenue. Moreover, investors sought more and more mortgages to be securitized (i.e., packaging multiple mortgages together and selling the package or slices of the package to investors) as housing prices increased over time and securitized loans represented solid investment opportunities. Collectively, the efforts of individual Americans, lenders, the housing industry, investors, and governments helped fuel a cycle leading to dramatic increases in the value of homes in many parts of America.

   During 2008, faith and belief in the high values of homes began to deteriorate, causing home prices to drop rapidly and threatening the stability of a number of financial institutions and the financial condition of many homeowners.

B. Federal Reserve – At the same time the housing bubble was occurring, the Board of Governors of the Federal Reserve System (the Fed) maintained exceptionally low interest rates. Arguments have been made that these favorable rates allowed banks and other

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[2] In March, the number of unemployed persons was little changed at 15.0 million, and the unemployment rate remained at 9.7 percent. Employment Situation Summary, Bureau of Labor Statistics, April 2, 2010, http://www.bls.gov/news.release/empsit.nr0.htm

[3] Public Law 111-21

[4] Under section 5(c)(1) of Public Law 111-21, the Commission is required to examine 22 specific factors and their role in causing the crisis.

[5] Under section (h)(1) of Public Law 111-21, the Commission's report is not due until December 15, 2010.

[6] For further information on the causes and responses by the federal government, please see…

[7] For instance, "A Government-Mandated Housing Bubble," by Peter J. Wallison and Edward J. Pinto, Forbes.com, February 16, 2009, http://www.forbes.com/2009/02/13/housing-bubble-subprime-opinions-contributors_0216_peter_wallison_edward_pinto.html.

financial companies to make money available to consumers at low rates.[8] In doing so, it helped fuel first-time home mortgages, home refinances, home remodelings, and second home loans. Many homeowners took on additional debt, including extracting a portion or all of the inflated value of their homes, because credit was so accessible and cheap.

C. Regulatory Agency Failures – Prudential financial regulators (e.g., Federal Reserve, Office of Thrift Supervision, Office of Comptroller of the Currency, Federal Deposit Insurance Corporation (FDIC), and state banking regulators) are charged with overseeing our nation's financial institutions and ensuring their safety and soundness. As financial companies increased their leverage and positions, diversified and expanded into unfamiliar transaction areas, and made capital available to unworthy borrowers, it was the responsibility of the regulators to conduct proper examinations, detect potential problem areas, and impose appropriate corrective measures for these risky practices. Arguments have been made that this did not always occur or at a sufficient level to prevent the crisis.[9]

D. Credit Rating Agencies – The Nationally Recognized Statistical Rating Organizations, typically referred to as credit rating agencies (e.g., Moody's Investor Services, Standard & Poor's, and Fitch Ratings), provide ratings for various financial products and instruments. These ratings are a determination of the probability that the product or instrument will default or fail to provide the financial outcome promised or expected. Prior to and during the start of the financial crisis, arguments have been made that the credit rating agencies did not sufficiently conduct due diligence and proper examinations.[10] As a result, inflated rating grades provided by credit rating agencies for many products and instruments, especially securitized home mortgages, helped cause a broad range of investors to make poor investments.

Federal Government Actions

In efforts to try to mitigate the impact of the financial crisis, a number of steps have been taken over the last 24 months or so by Congress, the Bush Administration, and the Obama Administration. These efforts have had varying degrees of success, and their long-term consequences may not be known for years or decades. Here are some of the major actions taken:

A. TARP – The Troubled Asset Relief Program (TARP), which was enacted as Title I of the Emergency Economic Stabilization Act,[11] provided the Treasury Department with up to $700 billion to be used to purchase troubled assets and for other purposes related to financial institutions. During implementation, both the Bush Administration and Obama Administration expanded the scope of TARP to include companies and functions outside the traditional definition of financial institution (i.e., GM and Chrysler).

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[8] For instance, "Economists Dispute Bernanke's Claim that Low Rates Didn't Fuel Crisis," by Dan Weil and Julie Crawshaw, Moneynews.com, January 13, 2010, http://moneynews.com/StreetTalk/ben-bernanke-rates-crisis/2010/01/13/id/346261.

[9] For instance, "Greenspan Says U.S. Regulators Failed During Financial Crisis," by Steve Matthews, Financial Post, March 19, 2010, http://www.financialpost.com/news-sectors/financials/story.html?id=2702759.

[10] For instance, "Ratings Downgrade," by James Surowiecki, The New Yorker, September 28, 2009, http://www.newyorker.com/talk/financial/2009/09/28/090928ta_talk_surowiecki.

[11] Public Law 110-343.

On March 12, 2010, in its latest statutorily required report,[12] the Treasury Department indicated that of the $545 billion intended to be used, $491.10 billion had been committed to specific institutions under contracts and $381.54 billion had been paid out under those contracts.[13] The latest estimates from the Congressional Budget Office (CBO) indicate that TARP, when it concludes, will lose approximately $109 billion,[14] which would predominantly come from investments made in AIG, GM, and the Obama Administration's housing programs.[15]

B. Obama Administration's Housing Programs – The Treasury Department, in cooperation with the Department of Housing and Urban Development, created a number of programs designed to lower the monthly mortgage costs of homeowners. In particular, the Home Affordable Refinance Program (HARP)[16] provides government refinancing for homeowners who are current on payments from mortgages that may be more risky or expensive into 30-year fixed loans with lower interest rates. The Home Affordable Modification Program (HAMP)[17] facilitates the modification of existing mortgages for those homeowners unable to afford their current mortgage to more affordable monthly payments. Since the initiation of these programs, the Administration has tweaked and expanded these individual programs several times to try to make them more functional. These changes, however, have had little effect on the low numbers of homeowners benefitting from the programs, especially HAMP. The latest report from Treasury indicates that as of March 30, 2010, only 230,000 homeowners obtained a permanent mortgage modification.[18] The most recent changes to the program include offering incentives to loan servicers, lenders, and investors to promote short sales and deeds-in-lieu.[19]

C. Federal Reserve Programs – The Fed created numerous programs to increase liquidity in the financial marketplace and to provide financial assistance to the overall market as well as to specific financial companies.[20] Through lending efforts, assets purchases, and asset guarantees, the Fed made funding and credit available to financial companies. Although most of these programs have ended,[21] the Fed now holds $1.033 trillion in mortgage-backed

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[12] Troubled Assets Relief Program Monthly 105(a) Report – March 2010, U.S. Department of the Treasury, April 12, 2010, http://www.financialstability.gov/docs/105CongressionalReports/March%202010%20105(a)%20monthly%20report_final.pdf
[13] Ibid., p. 7
[14] Report on the Troubled Asset Relief Program – March 2010, Congressional Budget Office, p. 1, http://www.cbo.gov/ftpdocs/112xx/doc11227/03-17-TARP.pdf
[15] Ibid., p. 3
[16] http://makinghomeaffordable.gov/refinance_eligibility.html
[17] https://www.hmpadmin.com/portal/programs/hamp.html
[18] Report on the Troubled Asset Relief Program – March 2010, Congressional Budget Office, p. 4, http://www.cbo.gov/ftpdocs/112xx/doc11227/03-17-TARP.pdf
[19] https://www.hmpadmin.com/portal/programs/foreclosure_alternatives.html
[20] Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet, Board of Governors of the Federal Reserve System, March 2010, http://www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport201003.pdf
[21] Ibid., p. 29

securities (i.e., Fannie Mae, Freddie Mac, and Ginnie Mae) and $167 billion in federal agency debt securities (i.e., Fannie Mae, Freddie Mac, and Federal Home Loan Banks).[22]

D. Bankruptcy/Structured Mergers of Large Financial Companies – At the end of 2008, then-Treasury Secretary Hank Paulson and Fed Chairman Ben Bernanke, in partnership with then-president of the Federal Reserve Bank of New York Timothy Geithner, worked to orchestrate the merger of large financial firms facing financial ruin and/or bankruptcy. As a result of these efforts, Bear Stearns was effectively merged with J.P. Morgan Chase and Merrill Lynch was effectively merged with Bank of America. After failing to find acceptable merger partners or the government signaling an unwillingness to provide financial assistance, Lehman Brothers and CIT Group separately entered bankruptcy.

   In addition, the FDIC seized IndyMac, subsequently purchased by OneWest Bank, and Washington Mutual Bank, subsequently purchased by J.P. Morgan Chase.

E. Fannie Mae and Freddie Mac – By guaranteeing questionable mortgages they securitized and growing their own loan portfolios with private label securitized mortgages, Fannie Mae and Freddie Mac put themselves on a path to financial collapse. Congress passed the Housing and Economic Recovery Act of 2008 just weeks after Fannie and Freddie's stocked dropped substantially due to a loss of confidence in the market. Among other powers, the law allowed the Federal Housing Finance Agency (FHFA) to place these entities in conservatorship or receivership. On September 7, 2008, the FHFA placed Fannie and Freddie into conservatorship, effectively making the quasi-public companies fully owned government corporations and recognizing the federal government's responsibility for their sizable debts and liabilities. CBO estimates that the cost from the losses of these two organizations will reach $389 billion over the next 10 years.[23]

Legislative History

S. 3217 was introduced on April 15, 2010, by Senator Dodd. That same day the bill was subsequently referred to the Senate Banking, Housing, and Urban Affairs Committee and reported as an original measure by Chairman Dodd. No written report was filed on the bill; however, on April 22, 2010, the committee made bill report language available on its Web site.[24]

Relatedly, the Senate Banking, Housing, and Urban Affairs Committee approved an unnumbered bill on March 23, 2010, by a vote of 13 to 10 with no Republican approving of the measure. During the committee's consideration, it adopted a Chairman's Mark, as amended by a Manager's Amendment. The text of the committee-passed bill as amended, with some additional changes, became the basis for S. 3217.

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[22] Ibid., p. 4

[23] CBO's Budgetary Treatment of Fannie Mae and Freddie Mac, Congressional Budget Office, January 2010, p. 8, http://www.cbo.gov/ftpdocs/108xx/doc10878/01-13-FannieFreddie.pdf

[24] Web site of the Senate Committee on Banking, Housing, and Urban Affairs, http://banking.senate.gov/public/_files/RAFSAPostedCommitteeReport.pdf

On December 2, 2009, the House of Representatives Committee on Financial Services Chairman Barney Frank introduced H.R. 4173, which was subsequently referred to the committees of jurisdiction. The House considered H.R. 4173 from December 8, 2009, to December 11, 2009, when the bill was approved by a vote of 223 to 202. On January 20, 2010, the bill was received in the Senate and referred to the Senate Committee on Banking, Housing, and Urban Affairs.

Prior to the introduction of H.R. 4173, the House Committee on Financial Services marked-up and approved a number of components of H.R. 4173 as separate bills and committee prints. The committee mark-up process began on October 14, 2009, and concluded on December 2, 2009.

Bill Provisions

Title I – Financial Stability

Title I establishes a new Financial Stability Oversight Council (the Council) to oversee the financial stability of the U.S. economy and markets. The bill provides the procedures, structure and other necessary components for operations of the Council, which would be made up of the heads of eight banking-related organizations—U.S. Treasury Department, which would be Chairperson, the Board of Governors of the Federal Reserve System, Office of Comptroller of the Currency (OCC), Bureau of Consumer Protection, Securities and Exchange Commission (SEC), Federal Deposit Insurance Corporation (FDIC), Commodity Futures Trading Commission (CFTC), and Federal Housing Finance Administration—and an independent expert on insurance.

The Council would formally bring together all federal financial regulators to improve financial regulation, maintain and monitor financial stability, promote market discipline, and coordinate the response of the federal government to future financial crises. The Council would enable coordination and communication across the U.S. financial regulatory system. In addition, the Council would be charged with deciding jurisdiction disputes between competing federal banking regulators and providing recommendations to federal banking regulators on the need for heighted or improved standards or safeguards for applicable bank holding companies and nonbank financial companies.

Subject to various factors and considerations, the bill allows the Council, by two-thirds vote and affirmative vote of the Chairperson, to determine that a U.S. or foreign nonbank financial company should be governed and subject to regulation by the Federal Reserve. A nonbank financial company that is subject to a determination by the Council would have the opportunity, except in extreme cases, for a hearing before the Council. An affirmative decision by the Council would be required to be reviewed, and possibly rescinded, not less than annually. Companies captured under this provision would be required to register with the Federal Reserve.

The Council may provide recommendations to the Federal Reserve on enhanced supervision requirements (i.e., reporting and disclosure requirements) and prudential standards for nonbank financial companies and large bank holding companies with assets greater than $50 billion, including risk-based capital requirements, leverage limits, liquidity requirements, concentration limits, and contingent capital requirements. Similarly, the Federal Reserve would be authorized, with approval of an affirmative vote of more than two-thirds of the Council and subject to a hearing process, to impose conditions on the activities of these companies or terminate one or more activities if the companies pose a grave threat to U.S. financial stability. In addition, the bill requires the Federal Reserve to: 1) establish prudential standards and reporting and disclosure requirements applicable to nonbank financial companies and large, interconnected bank holding companies that are more stringent than those imposed on other companies; 2) impose remediation efforts for distressed companies to minimize the probability of insolvency; and 3) issue and implement regulations within 18 months of the transfer date, as established by title III.

Subject to an appeal process, the bill requires a bank holding company that has assets greater than $50 billion as of January 1, 2010, and that received assistance under the Capital Assistance Program of the Troubled Asset Relief Program to be governed as if the Council approved it to be overseen by the Federal Reserve (this is the so-called Hotel California provision).

The bill creates a new Office of Research at the Treasury Department's Office of Financial Stability and provides the structure, duties, and budget for the office. For the first two years of operation, funding for the office would come from the Federal Reserve. Thereafter, the office would be funded by assessments imposed on Federal Reserve-supervised nonbank financial companies and bank holding companies with assets greater than $50 billion. The Director of the office would set the budget and direct the affairs of the office in consultation with the Council and the Council Chairperson, but without approval from other government officials or council member agencies.

Title II – Ordinary Liquidation Authority

Title II establishes an administrative process for resolving financial companies. Under this mechanism, the Treasury Secretary could appoint the FDIC as receiver for a financial company, if: 1) the FDIC and the Board of Governors, with not less than a two-thirds affirmative vote of each board, recommend such action; and 2) the Secretary makes determinations on, among other things, whether the covered financial company is in default or in danger of default, the effect of its failure on the stability of the U.S., whether private options exist to prevent default of the company, and the effect of a determination on claims or interests of the company. A new three-judge panel, named the Orderly Liquidation Panel and located in the U.S. Bankruptcy Court in Delaware, would then consider a petition filed by the Treasury Secretary to appoint the FDIC as receiver for a financial company. The panel would have 24 hours to consider the petition and issue an order, which can be appealed to the U.S. Court of Appeals for the Third Circuit and the U.S. Supreme Court. A financial company is defined as any bank holding company, nonbank financial company, or any other company that is "predominantly" engaged in financial activities. If appointed as receiver over a financial company, the FDIC is authorized to operate and wind up the company, including making bridge loans, resolving claims against the company, disposing of leases, disposing of company assets, replacing management, enforcing contracts, and potentially completely liquidating the company. Claims would be paid in the priority established by the bill, not in accordance with the priorities under the bankruptcy code. There is no time limit on receivership.

The bill provides that there is a strong presumption, but no mandate, that creditors and shareholders will bear the losses of the financial company. In addition, the FDIC is authorized to treat similarly situated unsecured creditors differently. The FDIC is obligated to pay claimants what they would have received in bankruptcy but, with the consent of the Treasury Secretary, is authorized to pay claimants, at its discretion, any additional amounts the FDIC determines necessary to minimize losses from the liquidation of the company.

To pay for the cost of receivership, the bill establishes a liquidation fund of $50 billion, which is funded through assessments on eligible companies (banking holding companies with assets greater than $50 billion, and nonbank financial companies supervised by the Fed). The FDIC may also borrow from the Treasury Department up to: 1) the amount of cash in the fund; and 2) 90 percent of the fair value of the assets of a company being resolved. In addition, the FDIC can levy assessments on any financial company, not just eligible financial companies, if the fund falls below $50 billion.

Title III – Transfer of Powers to the Comptroller of the Currency, the Corporation, and the Board of Governors

Title III terminates the Office of Thrift Supervision (OTS) and transfers its functions to the OCC, the Federal Reserve, and the FDIC. In addition, the Director of the Consumer Financial Protection Bureau is made a member of the board of the FDIC, replacing the director of the OTS. The bill also transfers regulatory supervision for state member banks and bank holding companies with assets less than $50 billion from the Federal Reserve to the OCC and the FDIC. Title III also outlines the transition and transfer process for funds, personnel and property of the OTS and the Federal Reserve. The transfer date would be one year from date of enactment but could be extended by an additional six months. In addition, the bill terminates the thrift charter.

Title IV – Regulation of Advisers to Hedge Funds and Others

Title IV requires advisers to hedge funds to register with the SEC. The SEC is given authority to impose recordkeeping and reporting requirements on registered investment advisers with respect to the private funds they manage. At a minimum, the information must include amount of assets under management, counterparty credit risk exposure, trading and investment positions, valuation policies, asset types, side letter arrangements, and trading practices. Because one of the driving reasons for collecting this information is systemic risk oversight, the SEC would consult with the Financial Stability Oversight Council about additional information requirements and would make the information available to the Council. The bill directs the SEC to conduct periodic inspections of private funds. The bill includes confidentiality protections for proprietary information.

The bill includes registration exemptions for venture capital fund advisers, private equity fund advisers, and advisers to family offices and directs the SEC to define those terms. Private equity fund advisers would be subject to modified recordkeeping and reporting requirements. The bill also raises the threshold for triggering federal adviser registration from those managing assets from $25 million to $100 million, which has the effect of leaving a greater portion of advisers subject to state regulation. Registered investment advisers would be required to take steps to safeguard client assets, including verification of assets by an independent public accountant.

The bill requires the SEC to raise the accredited investor threshold that governs who can invest in hedge funds and adjust the threshold for inflation at least every five years. The bill directs the SEC and CFTC, after consulting with the Financial Stability Oversight Council, to promulgate rules governing the reporting obligations of dually registered private fund advisers. Finally, title IV includes studies on the criteria for qualifying as an accredited investor with access to private investments, the feasibility of a self-regulatory organization for private funds, and short selling.

Title V – Insurance

Title V establishes the Office of National Insurance (ONI), within the Treasury Department. The ONI aims to address the lack of expertise on insurance matters at the federal level. In the wake of the insurance crisis caused by the September 11 attacks and the failure of AIG, the lack of any expertise on insurance at the federal level has been identified as a critical gap in the regulatory structure. The ONI would include: providing information to the new FSOC on insurers; coordinating federal efforts and policy on international insurance matters; overseeing the implementation of international insurance agreements; advising the Treasury Secretary on insurance matters; and consulting with state insurance agencies on national insurance matters. The office would also collect and analyze confidential and publically available information required from the insurance industry. The bill also authorizes the Treasury Secretary to negotiate and enter into International Insurance Agreements on Prudential Measures.

Separately, title V establishes the procedures for streamlining the treatment of nonadmitted insurance and reinsurance. Among other things, the bill would limit the regulation and corresponding fees and taxes for nonadmitted insurance products to the home state of the insured. For reinsurance, the bill would prevent a state from denying credit for reinsurance and regulating reinsurance products except for the domiciled state of reinsurer.

Title VI – Improvements to Regulation of Bank and Saving Association Holding Companies and Depository Institutions

Title VI codifies, for a three-year period, FDIC's regulatory policy of not approving applications for deposit insurance by an industrial bank, a credit card bank, or a trust bank that is owned or controlled by a commercial firm. Similarly, changes of control applications would be prohibited under the same restrictions unless the existing institution is in danger of default or is completed by two commercial firms.

The bill also imposes new regulations on bank holding companies. It allows the appropriate federal regulator to examine a bank holding company and subsidiaries of a bank holding company; scrutinize the acquisition of banks and nonbanks for potential risks on the stability U.S. financial system; prohibit transactions involving total assets greater than $25 billion or a savings association without the appropriate regulatory approval; and further scrutinize merger transactions for potential risks to the stability U.S. financial system. Similar examination requirements are imposed on savings and loan holding companies.

Further, bank holding companies would be required to be well capitalized and well managed, and interstate bank acquisitions would be subject to a higher threshold of capitalization and management for both the bank being purchased and the resulting bank. The bill would impose new restrictions on bank transactions with affiliates, limit lending applicable to credit exposure on derivatives transactions and other transactions, prohibit state insured banks to exceed national bank lending limits, impose limits on lending to insiders, and limit purchases by banks of assets from bank insiders.

Banks would be prohibited from converting from a national bank to a state bank, a state bank to a national bank or a federal savings association to a national bank or state savings association, if the institution is subject to an order or enforcement action for a significant supervisory matter by the applicable federal or state regulatory agency. In addition, the process for establishing new bank branches by a national bank would be eased by allowing branches that would have been permitted if the national bank was a state charted bank. The bill would allow the applicable regulator to impose new capital requirements for bank holding companies and savings and loan holding companies. The bill permits the appropriate federal banking regulator to require a bank holding company or a savings and loan holding company to serve as a source of strength for any subsidiary that is a depository institution. A securities holding company that does not have a bank or savings affiliate, but is regulated by a foreign regulator or subject by foreign law to supervision, may register and be regulated by the Federal Reserve.

Subject to a two-year transition period that could be extended to three years, the bill imposes new prohibitions on proprietary trading (defined to cover transactions for the trading book of the institution but exclude transactions conducted on behalf of a customer) by hedge funds or private equity funds that are also treated as bank holding companies or control an insured depository institution. The prohibitions under the bill do not include purchase of obligations of the U.S. government or U.S. government sponsored entities (Ginnie Mae, Fannie Mae, Freddie Mac,) or any obligations of a state. Completely non-U.S. companies would also be excluded from the prohibition. Similarly, the bill prohibits a bank holding company, an insured depository institution, or a company that controls a depository institution from sponsoring or investing in a hedge fund or private equity fund. Investments in small businesses or done to promote public welfare would be exempt. Moreover, such institutions and their subsidiaries would be prohibited from entering into covered transactions with a hedge fund or private equity fund. With certain exemptions, nonbank financial companies supervised by the Federal Reserve would be subjected to heightened capital requirements and additional quantitative limits if they are engaged in proprietary trading. Rules to implement the proprietary trading prohibitions would be subject to a study and further recommendation by the Council and a rulemaking by the appropriate federal banking regulator.

Additionally, under the bill, without prior approval from the Board under limited circumstances, one financial company would be prohibited from merging, consolidating or acquiring the assets of another financial company if doing so would result in a financial company that held more than 10 percent of the total aggregate consolidated liabilities of all financial companies.

Title VII – Improvements to Regulation of Over-the-Counter Derivatives Markets

Title VII establishes a heightened process for the regulation of the derivatives marketplace under a dual regulatory model with the CFTC regulating swaps and the SEC regulating security-based swaps. In particular, the bill creates the presumption that all swaps/security-based swaps should be cleared with a registered derivatives clearing organization (i.e., exchanges or clearinghouses) unless the CFTC or SEC provide an exemption. Exemptions would be limited, requiring a showing that a derivatives clearing organization would not accept it for clearing, or the swap counterparty is not a major swap participant and the party does not meet the eligibility requirements for a derivatives clearing organization. Even in that instance, the Financial Stability Oversight Council could still veto the exemption.

In general, if a clearing organization can clear a swap, the swap would have to be cleared. Registered derivatives clearing organizations would submit for preapproval a group, category, type or class of swaps/security-based swaps it seeks to clear. In addition, the SEC and CFTC would be required to identify swaps/security-based swaps that should be accepted for clearing based on a number of factors. To facilitate the overall process, the CFTC and SEC would jointly issue regulations providing uniform rules for the clearing of swaps/security-based swaps and the approval of derivatives clearing organizations.

Derivatives clearing organizations must comply with core principles outlined in the bill, including having adequate resources to operate, ability to manage risk associated with all of its functions, appropriate credit exposure, sufficient margin requirements of participants, timely settlements policies, procedures for dealing with insolvent participants or members, and adequate enforcement and monitoring procedures. In addition, the SEC and CFTC, or their designee, are required to make public aggregate swap data on trading volumes and positions.

The bill establishes the framework for the approval and requirements of swap/security-based swap repositories. Swap/security-based swap dealers and major swap/security-based swap participants would also be subject to new requirements, including requirements for registration, capital and margin, reporting and recordkeeping, business conduct, and conflicts of interest. Swaps subject to the clearing requirement are also subject to an exchange (or exchange-like alternative swap/security-based swap execution facility) trading mandate. Significantly, there is not an automatic exemption from margin requirements for transactions with end users. A margin exemption would be available only if the transaction satisfied the strict GAAP hedge accounting requirements. The CFTC and SEC would be authorized to set position limits with respect the aggregate number or amount of positions in contracts that may be held by any person in a number of circumstances, including for swap/security-based swap contracts that perform or affect a significant price discovery function with respect to regulated markets. Firms that are active in trading swaps/security-based swaps or that accumulate large positions in any swap/security-based swap, as determined by the SEC or the CFTC, would be subject to additional reporting and recordkeeping requirements.

Title VII requires the SEC, CFTC, the Council, and the Treasury Department to consult and coordinate with foreign regulatory authorities in order to promote international harmonization of swaps/security-based swaps. The bill also requires the SEC and CFTC, either through a new or existing advisory committee, to coordinate and develop common solutions for swap/security-based swaps, and to develop a joint fellowship program to enhance staff understanding about the interactions between financial markets and the economy. Title VII requires each fellow, upon completion of the program at which attendance is mandatory, to submit a written paper summarizing his or her observations from participating in the program and providing recommendations for enhancing the contribution of each agency to the stable functioning of the financial markets and the economy of the nation. The bill requires a GAO study on the implementation of the provisions and requires the SEC and CFTC to make recommendations on legislative changes to federal insolvency laws.

Title VIII – Payment, Clearing, and Settlement Supervision

Title VIII requires the Council, as established by title I, to designate systemically important financial market utilities or systemically important payment, clearing, or settlement activities. It also creates a process for the rescission of a designation, hearing from affected parties prior to making a designation, and providing written notification to the affected parties of such designation. The Board of Governors of the Federal Reserve is required to establish risk management standards for designated financial market utilities and related activities of financial institutions, including margin and collateral requirements, participant or counterparty default policies and procedures, timely clearing and settlement of financial transactions, capital and resource requirements, and minimum thresholds for application of such standards. A Federal Reserve Bank, if approved by the Board of Governors and subject to certain requirements, may establish an account for a designated financial market utility and provide similar services to the utility that it provides certain financial institutions, including access to its discount and borrowing privileges, earnings on any balances maintained, and lower reserve requirements.

Under the bill, the applicable regulatory agency with responsibly for the designated financial market utility is required to conduct an examination of the entity, in coordination with the Board of Governors, not less than annually. In addition, the Board of Governors could take emergency enforcement action against a designated financial market utility if the Board determines the designate financial market utility's actions or condition poses an imminent risk to financial institutions, critical markets, or the financial system. Similarly, the appropriate regulatory agency, or the Board of Governors if so delegated as the authority, is authorized under the bill to examine the designated activities of a financial institution to determine risk to the institution or other institutions, examine the functionality of the institution to control the risk of its activities, and ensure compliance with the standards issued pursuant to this title. The bill authorizes the collection of certain information from those entities that may be designated under this title and additional information from those that become designated. The bill grants broad rulemaking authority to the Board of Governors and the Council to carry-out the authorities and duties granted under this title.

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

Title IX formalizes the SEC's Investor Advisory Committee, creates a second SEC investor advocacy office, and facilitates investor testing by the SEC. It also gives the SEC clear authority to mandate pre-purchase disclosures to retail investors.

The bill attempts to streamline the rule approval process for self-regulatory organizations. The bill authorizes the SEC to reaffirm, prohibit, or restrict mandatory pre-dispute arbitration.

The bill directs the SEC to provide whistleblowers with awards of 10 to 30 percent of total monetary sanctions for information leading to successful enforcement actions and provides statutory protections for such whistleblowers. The bill authorizes the SEC to impose collateral bars across the securities industry for a violation in one part of the industry. The bill allows civil penalties to go into a fund for victim compensation even in cases in which there was no disgorgement. The bill also amends the Securities Investor Protection Act to increase the borrowing limit from Treasury from $1 billion to $2.5 billion and facilitate portfolio margining.

The bill reverses the National Securities Market Improvement Act and restores state regulatory authority over private securities offerings under Regulation D.

The bill imposes new requirements and significant new exposure to liability on credit rating agencies. In particular, the bill subjects NRSROs to greater internal control and conflict of interest requirements, including a requirement that at least half of the board of directors be independent. The bill establishes an office of credit ratings at the SEC that is charged with annually examining and writing rules for credit rating agencies. These rules relate, among other things, to credit rating methodologies, transparency, qualifications for analysts, and universal ratings symbols. Credit rating agencies will be required to refer tips to law enforcement, consider information from sources other than the issuer of a security. The bill gives the SEC authority to fine NRSROs, charge them with failures to supervise, and suspend or revoke their registration with respect to particular classes of securities. Finally, the bill requires studies on the use and possible rescission of ratings from federal, state, and local law; alternative models for credit rating agency compensation; the benefits of creating an independent professional rating analyst organization, and credit rating agency independence. The relevant agencies are directed, but not mandated, to remove rating requirements from their regulations.

The bill would require securitizers and originators of asset-backed securities to retain an aggregate five percent of the credit risk that is securitized unless the asset originator meets the underwriting standards prescribed by the regulators for the relevant asset class. The bill also requires disclosures about the underlying assets in securitized pools, the representations and warranties, and the repurchase requests across all trusts aggregated by the securitizer. Issuers would be required to perform due diligence analyses.

Under the bill, shareholders would be given an annual non-binding vote on the compensation of executives. The bill would require compensation committees of public companies to be independent and would allow compensation committees to hire independent advisers. The bill would require the disclosure of the relationship between executive compensation and financial performance of the company and any company policies permitting employees to hedge their holdings of company securities. Public companies would be required to establish policies to claw back past incentive-based compensation from executives if the company later issues a restatement. The bill also directs the Federal Reserve Board to extend to bank holding companies a prohibition on executive compensation plans that are "excessive" or could lead to material financial loss, and to impose punitive capital requirements on depositories with risky compensation practices.

The Division of Trading and Markets and the Division of Investment Management of the SEC would be required to have a staff of examiners to perform compliance inspections and examinations. The SEC would have to produce annual reports on enforcement, examinations, corporate filings reviews, and internal controls. The GAO would be required to conduct a number of reports on SEC management and structure and the oversight of self-regulatory organizations. The SEC's Inspector General would be required to set up a program for employees of the SEC to provide tips for improving the SEC.

The bill would limit the instances in which brokers could vote on behalf of shareholders without explicit instructions from the shareholder. Public company directors generally would be required to be elected by a majority vote of shareholders. The bill requires issuers to disclose whether they have separated the chairman and chief executive officer roles. The bill would also require the SEC to mandate proxy access for public companies, under which certain shareholders would be allowed to include their nominees at company expense in the corporate proxy materials in annual company elections.

The bill would require advisers to municipal issuers to register with the SEC and be subject to oversight. The bill would change the composition and terms of the Municipal Securities Rulemaking Board (MSRB). It would also give the MSRB expanded rulemaking and enforcement authority. The bill would require the GAO to study the municipal securities markets and the role and funding of the Government Accounting Standards Board. The GAO also would be required to make recommendations regarding the repeal of the Tower Amendment, which relates to disclosure by municipal securities issuers. Lastly, the bill creates a new office in the SEC to oversee municipal securities.

Title IX authorizes the Public Company Accounting Oversight Board to share information with foreign auditor oversight authority and expands the jurisdiction of the Public Company Accounting Oversight Board to include auditors of brokers and dealers.

The bill requires the SEC to promulgate rules required to securities lending.

The bill would raise the material loss thresholds for purposes of inspector general reviews by the FDIC and National Credit Union Association (NCUA) of bank and credit union failures.

The bill would establish a program administered by the CFPA to award grants for senior investor protection to states that have in place certain minimum rules governing securities and insurance.

Title IX makes certain changes with respect to inspectors general, including making additional inspectors general presidential appointees and requiring agencies to respond to deficiencies identified by inspectors general.

The bill also alters the funding mechanism for the SEC by allowing it to self-fund. In other words, its budget and funding would not be subject to the Appropriations Committee but would use fees imposed on the related industry for its operational costs.

Finally, Title IX requires a number of studies, the most important of which directs the SEC to conduct a study on the relative obligations of broker-dealers and investment advisers with respect to their retail customers and the need for legal and regulatory changes to achieve harmonization. Also included are studies on mutual fund advertising; conflicts of interest between firms' investment banking and analyst functions; investor access to information about investment advisers and broker-dealers; financial planners and financial designations; and proprietary trading at depositories, bank holding companies, financial holding companies, and related entities.

Title X – Bureau of Consumer Financial Protection

Title X establishes a new bureau to be located within the Board, named the Bureau of Consumer Financial Protection, to regulate consumer financial products and services. The bill provides the composition, procedures, and structure for the operations of the new agency. The structure includes separate units focused on research, community affairs, and consumer complaints. The Bureau would also have an office dedicated to fair lending and equal opportunities and an office of financial literacy. In addition, a new consumer advisory board is created by the bill to advise the Bureau and provide information on the emerging consumer products. Funding for the new agency's operations would come from Board with the level tied to the total operating budget of the Board (i.e., 10 percent in 2011, 11 percent in 2012, and 12 percent in 2013 and thereafter).

The Bureau would be provided an exceptionally broad mandate in terms of protecting financial consumers. These general obligations are as follows: 1) consumer have, understand, and can use information to make responsible decisions about consumer financial products or services; 2) consumers are protected from abuse, unfairness, deception and discrimination; 3) existing federal regulations are reviewed, identified and eliminated; 4) consumer financial law is enforced uniformly; and 5) markets for consumer financial products or services operate fairly and efficiently, with ample room for sustainable growth and innovation. Functions of the CFPA would include administering, enforcing, and otherwise implementing federal consumer financial law and its authority would include issuing or conducting rulemakings, orders, or guidance, to carry out its authority. In particular, the Bureau is required to supervise and conduct examinations of compliance with Federal consumer financial law for: 1) people involved in the origination, brokerage, service or modification of consumer mortgages; 2) large participants in other consumer financial products and services (to be defined by Bureau rulemaking); and 3) large banks, savings associations, and credit unions (i.e., those with greater than $10 billion in assets). In addition, the Bureau may review a sampling of prudential regulator examinations of smaller banks, savings associations and credit unions (i.e., those with less than $10 billion in assets). The Bureau is designated as the preeminent regulatory authority over other regulatory agencies in terms of issuing regulations on federal consumer financial laws.

As a check mechanism, the Council, as created by title I, would have authority to review and set aside, by a vote of two-thirds of its members, a final regulation of the Bureau to preserve safety and soundness of the banking system or U.S. financial stability.

To the extent the Bureau and another federal banking agency issue conflicting supervisory actions, the affected entity subjected to the actions may seek an appeal to an ad hoc governing body made up of noninvolved representatives of the Bureau and the other federal banking agency, with minor exceptions.

In addition to providing the Bureau with authority to exempt any class or product from coverage, the bill provides a limited carve-out to the scope of applicable entities subjected to Bureau authority. Specifically, narrow exemptions are provided for the following: 1) merchants, retailers, or sellers of nonfinancial goods and services; 2) merchants, retailers, and sellers offering certain credit for nonfinancial goods; 3) real estate brokers and agents; 4) manufactured home retailers and modular home retailers; 5) certified public accountants and tax preparers; 6) attorneys; 7) those regulated by state securities commission; 8) those involved in employee benefits and compensation plans; 9) those regulated by the state securities commission; 10) those regulated by the SEC; 11) those regulated by the CFTC; 12) those involved in charitable contributions; and 13) those engaging in the business of insurance.

The Bureau would have the right to eliminate pre-dispute arbitration, if it found it in the public interest to do so. It would also be able to regulate disclosure notices to ensure proper attention is given to the risks, costs and benefit of the financial product or service. Under the bill, consumers would have full access to any non-confidential material maintained by those covered by the title.

The bill effectively creates the floor for regulating consumer financial products and services and allows states to add additional requirements as long not inconsistent with the federal requirements. Further, state attorneys general would be authorized to enforce the provisions of this title or Bureau’s regulations. States would also have the right to apply any general applicable state consumer protection or any requirement on a state bank (or savings association) against a national bank (or federal savings association) unless it discriminates against national banks or is inconsistent with federal law.

Existing consumer protection authority in the following agencies would be transferred to the Bureau at a date to be picked by the Secretary of the Treasury (not earlier than 180 days and not later than 24 months from enactment): the Board, FDIC, FTC, National Credit Union Association, OCC, OTS, and HUD. Applicable federal employees in those agencies would be transferred to the Bureau.

The bill authorizes the Bureau to conduct extensive collection of data, including information on loans of women-owned and minority-owned small businesses. The bill also bans prepayment penalties for residential mortgage loans, but allows qualified mortgages to impose penalties for up to three years from consummation.

Title XI – Federal Reserve System Provisions

Title XI alters the existing authority of the Board of Governors of the Federal Reserve, as provided in section 13(3) of the Federal Reserve Act. Specifically, the bill allows the Federal Reserve to establish broad-based loan programs and facilities, collateralized to the satisfaction of the Federal Reserve. The Board would be required to provide written justification to Congress within seven days of providing assistance under its emergency power. Moreover, the Federal Reserve would be required to disclose specific information on assistance provided under such powers within one year of providing assistance, unless doing so would reduce the program's effectiveness or would have a significant effect on the economic or financial market conditions. The bill also authorizes the GAO to conduct an audit and oversight, with certain limitations, of specific assistance programs created by the Federal Reserve in response to the 2008 financial crisis. GAO is required to make its findings available to Congress within 90 days of completion but is prohibited from disclosing certain information of the program.

The bill requires the FDIC to create a widely available program to guarantee obligations of solvent depositories or depository holding companies based on written determination by the new Financial Stability Oversight Council and the Federal Reserve that a "liquidity event exists" (a broadly defined term presumably intended to cover any situation in which the ability to sell and buy assets or obtain access to credit is unusual). As soon as practicable, the FDIC would be required to issue regulations, policies, and procedures for the issuance of such guarantees. A guarantee program would last during times of economic distress (undefined term) but would exclude guarantees of equity in an institution. The FDIC could seek collateral for its guarantees but would not be required to do so, and the maximum amount of debt allowed to be guaranteed by the FDIC would be set by the Secretary of the Treasury. The President *may* submit a written report to Congress on the FDIC's plan to issue guarantees up to the maximum amount set by the Treasury Secretary or to increase the maximum amount. The FDIC would be authorized to move forward unless Congress enacted a disapproval resolution within five days of the President's submission. Under the program, the FDIC would be authorized an unlimited amount of funds to carry out the guarantees. The FDIC would be required to charge fees and other assessments from participants to offset projected losses and administrative expenses, and to impose a special assessment on program participants to make-up for any shortfall.

The bill also makes modifications to the selection process for the President of the Federal Reserve Bank of New York, requiring a presidential appointment (and consequent potential for increased politicization of monetary policy) and establishes a new position at the Federal Reserve called the Vice Chairman for Supervision.

Title XII – Improving Access to Mainstream Financial Institutions

Title XII authorizes the Treasury Secretary to create a program of grants, cooperative agreements, financial agency agreements and other means to provide low- and moderate-income individuals to establish accounts in a federally-insured deposit institution. The purpose of the program would be to increase access to small-value loans and financial education and counseling. The bill also authorizes the Secretary to provide grants and other support for the establishment of demonstration programs to provide low-cost, small loans with reasonable terms and conditions as an alternative to payday loans. Grant recipients would be required to offer financial literacy and education for its consumers. In addition, the bill creates a third grant program to subsidize the losses suffered by community development financial institutions on such small dollar loans (i.e., less than $2,500, repayable installments, and with no prepayment penalty) made to consumers.

Cost

CBO "estimates that enacting S. 3217 would increase revenues by $32.4 billion over the 2011-2015 period and by $75.4 billion over the 2011-2020 period and increase direct spending by $25.8 billion and $54.4 billion, respectively, over the same periods. In total, CBO estimates those changes would decrease budget deficits by $6.6 billion over the 2011-2015 period and by $21.0 billion over the 2011-2020 period. In addition, CBO estimates that implementing the bill would increase spending subject to appropriation by $4.6 billion over the 2011-2015 period and $13.2 billion over the 2011-2020 period."[25] The budget deficit reduction outcome is primarily the result of the capitalization, i.e., imposition of assessments, for the Orderly Liquidation Fund, as created by section 210(n) of S. 3217.[26] The CBO also indicated that the assessments to pay for the Orderly Liquidation Fund would reduce income and payroll tax receipts, since the assessments would be tax deductibleand additional expenses would result in decreases in taxable income somewhere in the economy.[27]

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[25] Congressional Budget Office Cost Estimate for S. 3217, Restoring American Financial Stability Act of 2010, p. 2 http://www.cbo.gov/ftpdocs/114xx/doc11454/s3217.pdf
[26] Ibid., p. 2
[27] Ibid., p. 10.