# Financial Regulatory Reform
# Adapting to the New Normal

**The Dodd Frank Wall Street Reform and Consumer Protection Act**

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# Our Host: Blank Rome

Peter Peyser

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  - 525 Attorneys
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  - 30 Professionals
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# Financial Reform Watch

**Peter Peyser**


- A leading-edge source of news and analysis:
  - begun as e-mail alerts in Spring 2008
  - live on the web in January 2009
  - more than 82,000 hits
  - almost 8,000 hits in June 2010
  - more than 4,000 downloads monthly
- Quoted in business publications and media outlets in the U.S. and abroad.

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# Today’s Agenda

**Peter Peyser**

- **Peter Peyser: Political Context**

- **J.C. Boggs: New Rules for Banks and Derivatives**

- **Tom Westle: Hedge Fund Regulation**

- **Fred Lipman: Executive Compensation / Corporate Governance**

- **Tom Biron: Restructuring / “Funeral Plans”**

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# Our Presenters

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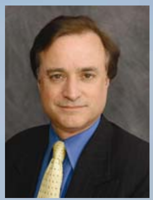
# Political Context



**Peter Peyser**

# Political Context

**Peter Peyser**

- Reform Fatigue?
- Big Institutional Changes:
  - Changed Roles / New Players
- New Tools vs. New Rules

# Regulations Ahead

**Peter Peyser**

- Significant decisions remain on scope and impact of provisions.
  - Who will affect the process?
  - Political risk during the implementation phase

# New Rules
# for
# Banks and Derivatives

**J.C. Boggs**

# New Rules for Banks

**J.C. Boggs**

## Capital Requirements,

## Bank Fees,

## and

## the “Volcker Rule"

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# New Rules for Banks

**J.C. Boggs**

## Financial Stability Oversight Council

- Creation of new Council – including existing financial regulators –
  - will monitor system-wide risks, and if necessary, make recommendations to the Federal Reserve to impose stricter rules, including new capital requirements and greater risk management.
- The bill establishes a floor for capital that cannot be lower than the standards in effect today.

## FDIC

- Make permanent an increase in federal deposit insurance to $250,000 per account.
- Increase mandatory size of the FDIC deposit insurance fund through an increase in assessments on some banks.
- The insurance increase is retroactive to January 1, 2008.

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# Consumer Protection Bureau

**J.C. Boggs**

- A new, independent Bureau of Consumer Financial Protection.
- Created within the Federal Reserve system.
- Responsible for enforcing consumer protection laws and regulations for:
  - banks and credit unions with assets of more than $10 billion, and
  - all mortgage-related businesses and payday lenders.

# Volcker Rule

**J.C. Boggs**

- Section 619 requires regulators to:
  - implement regulations for banks, their affiliates, and holding companies to limit proprietary trading and sponsorship of, and investment in, hedge funds and private equity funds.
- Non-bank financial institutions supervised by the Fed will also have restrictions on proprietary trading and investments in hedge and private equity funds.

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# Volcker Rule

**J.C. Boggs**

- The final, watered-down Volcker Rule
  - allows banks to invest up to three percent of their Tier 1 capital in private equity and hedge funds, but
  - bars banks from owning more than a three percent ownership stake in any private equity group or hedge fund.

# Volcker Rule

**J.C. Boggs**

- Regulations will take effect two years after enactment, and
- Regulated entities will have two more years to become compliant.

# TITLE VII

## Wall Street Transparency and Accountability

**J.C. Boggs**

## Derivatives:

## Central Clearing and Trading,

## Increased Market Transparency, and

## Regulating Foreign Exchange Transactions

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# TITLE VII

## Wall Street Transparency and Accountability

**J.C. Boggs**

- The bill would bring the over-the-counter financial derivatives market under significant government regulation for the first time.
- Many derivatives would have to be traded on exchanges and routed through clearinghouses, with regulators examining trades before they are cleared.
- Swaps could still be traded over-the-counter but would have to be reported to central repositories.

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# TITLE VII

## Wall Street Transparency and Accountability

**J.C. Boggs**

- Regulators could impose margin requirements for derivatives that are not required to go through a clearinghouse.
- The measure would provide some exemptions from the new rules for end users that are using derivatives to hedge business risks.

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# TITLE VII

**Wall Street Transparency and Accountability**

**J.C. Boggs**

## Capital and Margin Requirements –

- Each registered swap dealer and major swap participant for which there is a prudential bank regulator (*i.e.,* Fed, OCC, and FDIC) shall meet such minimum capital requirements as the prudential regulator shall by rule or regulation prescribe.
- The Commodity Futures Trading Commission (CFTC) shall prescribe capital and margin requirements for swap dealers and major swap participants for which there is not a prudential regulator.

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# TITLE VII

## Wall Street Transparency and Accountability

**J.C. Boggs**

- Banks will be required to spin off their riskiest derivatives-trading operations to affiliates.
- Closes Regulatory Gaps by providing the SEC and CFTC with authority to regulate over-the-counter derivatives so that irresponsible practices and excessive risk-taking can no longer escape regulatory oversight.

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# TITLE VII

## Wall Street Transparency and Accountability

**J.C. Boggs**

- Requires central clearing and exchange trading for derivatives that can be cleared and provides a role for both regulators and clearing houses to determine which contracts should be cleared; requires SEC and CFTC to pre-approve contracts before clearing houses can clear them.
- Financial assistance from the federal government to swap entities would be prohibited in order to discourage depository institutions from engaging in derivative activity.

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# TITLE VII

## Wall Street Transparency and Accountability

**J.C. Boggs**

- The CFTC would handle regulatory functions for non-security based swaps while the SEC would handle security-based swaps.
- The legislation would require that both regulators treat similar swap products or entities in a similar manner and jointly prescribe regulations regarding mixed swaps that could fall under the jurisdiction of either agency.

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# TITLE VII

## Wall Street Transparency and Accountability

**JC Boggs**

- **Reporting and Recordkeeping**
  - Requires data collection and publication through clearing houses or swap repositories to improve market transparency and provide regulators important tools for monitoring and responding to risks.
- **Foreign exchange swaps**
  - Will be regulated like all other Wall Street contracts.
  - At $60 trillion, this is the second largest component of the swaps market.

# TITLE VII

## Wall Street Transparency and Accountability

**JC Boggs**

- **Regulators** will be given broad enforcement authority to punish bad actors that knowingly help clients defraud third parties or the public, and doubles penalties for evading the clearing requirement.
- **Business Conduct Standard** establishes a code of conduct for all registered swap dealers and major swap participants when advising a swap entity – when acting as counterparties to a pension fund, endowment fund, or state or local government, dealers are to have a reasonable basis to believe that the fund or government entity has an independent representative advising them.

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# TITLE VII

## Wall Street Transparency and Accountability

**JC Boggs**

- **Effective Date:** unless otherwise provided, the provisions shall take effect
  - **360 days after the date of enactment**, or
  - to the extent a provision requires a rulemaking, **not less than 60 days after the publication of the final rule or regulation** implementing such provision.

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# Private Fund Investment Advisers Registration Act of 2010

## (Title IV)

**Tom Westle**

# Registration of Private Fund Advisors

## Overview

Tom Westle

- **Purpose:** To end the shadow financial system by requiring advisers of hedge funds and private equity funds to register with the SEC and to provide information about their trades and portfolios necessary to assess systemic risk.
- **Effective Date:** One year after the date of the enactment of the Dodd-Frank Act, unless otherwise provided, but an adviser may register with the SEC during the one-year period.

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# Registration of Private Fund Advisors

## Overview

**Tom Westle**

- **SEC Registration:** Title IV amends the investment adviser registration requirements under the Investment Advisers Act of 1940, eliminating the exemption that many hedge fund and private equity fund advisers currently rely upon and providing new exemptions;
    - New exemptions include ones for foreign private advisers, advisers to small business investment companies, venture capital fund advisers, small private fund advisers (advisers with less than $150 million assets under management (AUM)), and family offices.

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# Registration of Private Fund Advisors

## Overview

**Tom Westle**

- **Recordkeeping & Reporting Requirements**:
  - Authorizes the SEC to require registered investment advisers to maintain records – for periods as the SEC prescribes – and to file reports regarding the advised private funds as necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk by the Financial Stability Oversight Council.
- **Expansion of State Supervision:**
  - Raises the AUM threshold of advisers permitted to register with the SEC from $25 million to $100 million.

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# Changes to SEC Registration Requirements

**Tom Westle**

## Changes to Exemptions from Registration

- Eliminates the fewer than 15 clients exemption, bringing many hedge fund and private equity fund advisers under SEC regulation.
- Adds a new definition for the term private fund: an issuer that would be an investment company, but for Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act of 1940.
- Limits the intrastate adviser exemption in Section 203(b)(1) by requiring registration for investment advisers to any private fund.
- Limits the CFTC registered adviser exemption in Section 203(b)(6) by requiring registration for any investment adviser to a private fund if the business becomes predominately the provision of securities-related advice after the date of enactment.

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# Changes to SEC Registration Requirements

**Tom Westle**

## New Exemptions from Registration

- Small Private Fund Advisers – exempts any adviser that (i) acts solely as an adviser to private funds, and (ii) has AUM of less than $150 million in the U.S.
  - The SEC will require these exempt advisers to maintain such records and provide the SEC such annual or other reports as the SEC determines necessary or appropriate in the public interest or for the protection of investors.
- Venture Capital Fund Advisers – exempts advisers who solely advise one or more venture capital funds.
  - The SEC will define the term venture capital fund within one year after the date of enactment.
  - The SEC will require these exempt advisers to maintain such records and provide the SEC such annual or other reports as the SEC determines necessary or appropriate in the public interest or for the protection of investors.

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# Changes to SEC Registration Requirements

**Tom Westle**

## New Exemptions from Registration

- Foreign private adviser – exempts any adviser that:
    - A. has no place of business in the U.S.;
    - B. has, in total, fewer than 15 clients and investors in the U.S. in private funds advised by the investment adviser;
    - C. has aggregate AUM attributable to clients in the U.S. and investors in the U.S. in private funds advised by the investment adviser of less than $25 million, or such higher amount as the SEC may deem by rule; and
    - D. neither holds itself generally to the U.S. public as an investment adviser; nor acts as an investment adviser to:
        - any registered investment company; or
        - a company that has elected to be a business development company.

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# Changes to SEC Registration Requirements

**Tom Westle**

- Exempts from registration any investment adviser, other than an entity that has elected to be regulated or is regulated as a business development company pursuant to Section 54 of the Investment Company Act of 1940, who solely advises:

  A. small business investment companies licensed under the Small Business Investment Act of 1958;

  B. entities that have received notice to proceed to qualify as a small business investment company; and

  C. affiliates of licensed small business investment companies and who have a pending application to be licensed under the Small Business Investment Act.

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# Changes to SEC Registration Requirements

**Tom Westle**

- Excludes family offices from the definition of investment adviser.
  - The SEC will set requirements for a family office to qualify for the exclusion.
  - Family offices not required to be registered on January 1, 2010, will be grandfathered from registration, but will be subject to the anti-fraud provisions.

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# Recordkeeping & Reporting
## Requirements

**Tom Westle**

- The SEC may require any registered investment adviser to maintain records, for periods as the SEC prescribes, and to file reports with the SEC regarding the advised private funds as necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk by the Financial Stability Oversight Council.

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# Recordkeeping & Reporting Requirements

**Tom Westle**

- The information required to be maintained and subject to SEC inspection for each advised private fund includes:
  A. the amount of AUM and use of leverage, including off-balance sheet leverage;
  B. counterparty credit risk exposure;
  C. trading and investment positions;
  D. valuation policies and practices of the fund;
  E. types of assets held;
  F. side arrangement or side letters, whereby certain investors in a fund obtain more favorable rights or entitlements than other investors;
  G. trading practices; and
  H. such other information as the SEC, in consultation with the Council, determines what is necessary and appropriate in the public interest and for the protection of investors or for the assessment of systemic risk.  This may include the establishment of different reporting requirements depending on the type or size of the private fund.

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# Expansion of State Supervision

## Change in AUM Threshold

**Tom Westle**

- Title IV amends Section 203A(a) of the Investment Advisers Act by raising the AUM threshold of advisers permitted to register with the SEC from $25 million to $100 million.
- Advisers will be subject to state jurisdiction if they have less than $100 million AUM *and* are required to be registered and examined by the state where they are located.
- If an adviser would be required to register with 15 or more States, the adviser may register with the SEC.

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# Other Title IV Amendments

**Tom Westle**

- ***Investment advisers to mid-sized private funds*****:** The SEC will take into account the size, governance, and investment strategy of such funds to determine whether they pose systemic risk, and will provide for registration and examination procedures that reflect the level of systemic risk posed by such funds.
- ***SEC rulemaking authority*****:** Clarifies the SEC's rulemaking authority to adopt rules and regulations to define technical, trade, and other terms used in the Investment Advisers Act. For purposes of certain antifraud provisions of the Investment Advisers Act, the SEC is prohibited from defining the term, client, to include an investor in a private fund managed by an investment adviser.

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# Other Title IV Amendments

**Tom Westle**

- ***Custody of client assets***: Requires registered advisers to take such steps to safeguard client assets over which such adviser has custody, including, without limitation, verification of such assets by an independent public accountant, as the SEC may prescribe.
  - The U.S. Comptroller General will conduct a study and report on the compliance costs associated with current SEC rules (Rule 204-2 (books and records) and Rule 206(4)-2 (custody rule)) regarding custody and the additional costs if subsection Rule 206-4(b)(6) relating to operational independence were eliminated.

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# Other Title IV Amendments

**Tom Westle**

- ***Effect on Commodity Exchange Act*:** Clarifies that the Investment Advisers Act does not relieve any person of any obligation or duty, or affect the availability of any right or remedy available to the CFTC or any private party, arising under the Commodity Exchange Act governing commodity pools, commodity pool operators, or commodity trading advisers.

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# Other Title IV Amendments

**Tom Westle**

## Adjusting the accredited investor and qualified client standards

- The SEC will:
  - Adjust the net worth accredited investor standard, as defined under the Securities Act of 1933, for natural persons to exclude the value of the person's primary residence.
  - Initially review the accredited investor definition as it applies to natural persons (excluding the net worth standard) to determine whether the requirements should be adjusted for the protection of investors, in the public interest, and in light of the economy.

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# Other Title IV Amendments

**Tom Westle**

## The SEC will:

- Subsequently review the accredited investor definition, in its entirety (under Rule 215 under Regulation A under the Securities Act of 1933), as it applies to natural persons at least every four years, starting four years after the date of enactment, to determine whether the definition should be adjusted.
- Adjust the dollar tests in Rule 205-3 under the Investment Advisers Act (the qualified client threshold for charging compensation based on capital appreciation) for the effects of inflation within one year of enactment and every five years thereafter.

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# GAO Studies & SEC Studies

**Tom Westle**

- The U.S. Comptroller General will conduct a study and report on the appropriate criteria for determining the financial thresholds or other criteria needed to qualify for accredited investor status and eligibility to invest in private funds within three years after the date of enactment.
- The Comptroller General will conduct a study and report on the feasibility of forming a self-regulatory organization to oversee private funds within one year after the date of enactment.

# GAO Studies & SEC Studies

**Tom Westle**

- The SEC will conduct a study and report on the state of short selling on national securities exchanges and in the over-the-counter markets, giving particular attention to the impact of recent rulemaking and the incidence of the failure to deliver shares sold short or the delivery of shares on the fourth day following the short sale transaction, within two years after the date of enactment.
- The SEC will conduct a study and report on the feasibility, costs, and benefits of requiring real time, public reporting of short sale positions of publicly listed securities, and of a voluntary pilot program where public companies will agree to have all trades of their shares marked short, market maker short, buy, buy-to-cover, or long, and reported in real time through the Consolidated Tape within one year after the date of enactment.

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# Impact of the Volcker Rule

Tom Westle

- The Conference Report retained a revised version of the Volcker Rule found in the Senate bill.
- The Volcker Rule generally prohibits any banking entity from engaging in proprietary trading or from investing in or sponsoring a hedge fund or a private equity fund, subject to several exceptions.

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# Impact of the Volcker Rule

**Tom Westle**

- The **most significant change** from the Senate bill is that **banking entities are now allowed to invest up to three percent of their capital in hedge funds and private equity funds,** instead of a general ban.
  - A banking entity making a *de minimis* investment will be required to actively seek unaffiliated investors to reduce or dilute its investment to not more than three percent of the total ownership of the fund, and the investment must be immaterial to the banking entity. But the aggregate of all the interests of the banking entity in all such funds may not exceed three percent of the Tier 1 capital of the banking entity.

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# Executive Compensation and Corporate Governance

## (Title IX)

**Frederick D. Lipman, Esq.**

# Highlights of the Dodd Frank Act

Fred Lipman

- The Dodd Frank Act (the "Act") contains (with exceptions) mandates on executive compensation and corporate governance for all listed public companies, such as:
  - Say-on-pay, including golden parachutes
  - Compensation committee independence
  - Clawbacks
  - Enhanced executive compensation disclosures, including hedging disclosures
  - Broker voting and proxy access
  - Disclosures concerning dual CEO/Chair roles

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# Application of Act

**Fred Lipman**

- The executive compensation and corporate governance provisions of the Act apply generally to issuers with an equity security listed on a national securities exchange or a national securities association.
- The executive compensation and corporate governance provisions of the Act also apply, in certain cases, to unlisted companies which are subject to the SEC proxy rules contained in Section 14 of the Securities Exchange Act of 1934.
- The term “listed companies”, in this presentation, generally refers to both categories.

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# Say-on-Pay

(Title IX, Subtitle E, Section 951),

**Including Golden Parachutes**

**Fred Lipman**

- Listed companies must offer their shareholders a vote on executive compensation at first annual or other shareholders meeting occurring six months after enactment.
- Listed companies must offer shareholders a chance on the next proxy vote (and again every six years), on how often they want to take the vote – every year, every other year, or every three years.

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# Say-on-Pay

(Title IX, Subtitle E, Section 951),

**Including Golden Parachutes**

**Fred Lipman**

- In any proxy (or consent) solicitation where shareholders will be asked to approve a merger, consolidation, acquisition or proposed sale or other disposition of all or substantially all of the assets of a company, the following **<u>must be disclosed and a separate, nonbinding shareholder vote must be held to approve</u>**:
  - Any agreements or understandings with named executive officers concerning **<u>any type of compensation</u>** that is based on or otherwise relates to the merger, consolidation, acquisition, or proposed sale or other disposition of all or substantially all of the assets of the company.
  - The aggregate total of all such compensation that may (and the conditions upon which it may) be paid or become payable to or on behalf of such executive officer.

# Compensation Committee Independence

(Title IX, Subtitle E, Section 952)

**Fred Lipman**

- Standards for listing any equity security on a national securities exchange or association will require that compensation committees consist of only “independent” directors, subject to exceptions.
- SEC rules will require, in determining “independence”, consideration of the source of compensation of board members, including consulting, advisory, or other compensatory fees, and whether the board member is an affiliate.

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# Compensation Committee Independence

(Title IX, Subtitle E, Section 952)

**Fred Lipman**

- The Independent Compensation Committee of a listed company may **only select** a compensation consultant, legal counsel, or other compensation advisor after taking into consideration factors identified by the SEC, such as:
    - The provisions of other services to the company by the person that employs the advisor.
    - The amount of fees received from the company by the person that employs the advisor as a percentage of his or her total revenue.
    - The policies and procedures of the person that employs the advisor that are designed to prevent conflict of interests.

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# Compensation Committee Independence

(Title IX, Subtitle E, Section 952)

Fred Lipman

  - Any business or personal relationship of the advisor with a member of the compensation committee.
  - Any stock of the company owned by the advisor.
- The mere fact that a compensation committee retains the services of an advisor **<u>does not require</u>** the compensation committee to implement the advice or recommendations of the advisor.
- SEC study on compensation consultants due in two years.

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# Executive Compensation Disclosures

(Title IX, Subtitle E, Section 953)

**Fred Lipman**

## ▪ Disclosure of Pay vs. Performance

- The SEC shall require each listed company to disclose in any proxy statement or solicitation for an annual meeting of shareholders **a clear description** of any compensation required to be disclosed under the proxy disclosure rules, including:
  - Information that shows the **relationship between executive compensation actually paid and the financial performance of the company** (taking into account any change in the value of shares of stock and dividends of the company and any distributions).

# Executive Compensation Disclosures

(Title IX, Subtitle E, Section 953)

Fred Lipman

## Additional Disclosure Requirements

- The SEC shall require each listed company to disclose in any filing which requires disclosure regarding the compensation of a company's named executive officers the following:
  - The **median of the annual total compensation** of all employees, except the CEO, of the company.
  - The **annual total compensation** of the CEO of the company.
  - The **ratio** of the median of the annual total compensation of all employees of the company to the annual total compensation of the CEO of the company.

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# Clawbacks

(Title IX, Subtitle E, Section 954)

**Fred Lipman**

SEC must, by rule, require national securities exchanges and associations to prohibit the listing of any company that does not:

- Develop, implement, and disclose its policy on incentive-based compensation that is based on financial information required to be reported under the securities laws.
- Set a policy whereby the company can **clawback incentive compensation** if it was based on **inaccurate financial statements** that do not comply with accounting standards.

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# Clawbacks

(Title IX, Subtitle E, Section 954)

Fred Lipman

- In the event that the company is required to prepare an accounting restatement due to the material noncompliance of the company with any financial reporting under the securities laws, **recover from any current or former executive** who received incentive-based compensation (including stock options awarded as compensation) during the **three- year** period preceding that date on which the company is required to prepare an accounting restatement, based on the erroneous data, in excess of what would have been paid to the executive officer under the accounting restatement.

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# Disclosure Regarding Employee and Director Hedging

(Title IX, Subtitle E, Section 955)

**Fred Lipman**

- The SEC shall require companies to disclose in any proxy or solicitation material for an annual meeting of the shareholders whether **any employee or member of the board of directors, or any designee of such employee or member**, is permitted to purchase financial instruments that are designed to **hedge or offset any decrease in the market value of equity securities**:
  - Granted to the employee or member of the board of directors by the issuer as part of the compensation of the employee or member of the board of directors; or
  - Held, directly or indirectly, by the employee or member of the board of directors.

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# Enhanced Compensation Structure Reporting

(Title IX, Subtitle E, Section 956)

**Fred Lipman**

- Requires Federal financial regulators to prescribe regulations or guidelines to disclose to the appropriate Federal regulator the structures of all incentive-based compensation arrangements offered by covered financial institutions sufficient to determine whether the compensation structure:
  - Provides an executive officer, employee, director or principal shareholder with <u>excessive compensation, fees or benefits</u>; or
  - Could lead to <u>material financial loss</u> to the financial institution.
- Within nine months of enactment, prohibit types of incentive-based compensation that encourage inappropriate risks by covered financial institutions.
- Financial institutions with less than $1 billion in assets will be exempt from these requirements.

# Voting by Brokers

(Title IX, Subtitle E, Section 957)

**Fred Lipman**

- Brokers are prohibited from voting securities unless the beneficial owner has instructed the broker how to vote the proxy on the following:
  - Election of directors
  - Executive compensation
  - Any significant matter, determined by the SEC, by rule
  - Does not include a vote with respect to the uncontested election of a member of the board of directors of any investment company registered under the 1940 Act.

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# Strengthening Corporate Governance – Proxy Access

(Title IX, Subsection G, Section 971)

**Fred Lipman**

- Allows the SEC to require that a solicitation of proxy, consent, or authorization of a company include a nominee submitted by a shareholder to serve on the board of directors of the company.
- The SEC may issue rules permitting the use by a shareholder of proxy solicitation materials supplied by a company for the purpose of nominating individuals to membership on the board of directors of said company.

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# Disclosures Regarding Chairman and CEO Structures

(Title IX, Subtitle G, Section 972)

**Fred Lipman**

- The SEC shall issue rules that require a company to disclose in the annual proxy sent to investors the reasons why the company has chosen:
  - The same person to serve as chairman of the board of directors and CEO.
  - Different individuals to serve as chairman of the board of directors and CEO.

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# Restructuring
# and
# “Funeral Plans”

**Tom Biron**

# Overview of Funeral Plan and Liquidation Provisions

**Tom Biron**

- The statute seeks to avert future crises by giving government regulators the power to seize control of failing financial institutions, break them apart, sell off the assets and put them out of business, with shareholders and creditors taking losses.
- It accomplishes this goal in a two-step process:
  - Planning – Development of a Plan for the rapid and orderly “resolution” in the event of material financial distress or failure.
  - Implementation – Appointment of FDIC as receiver to liquidate failing financial companies that pose a significant risk to the financial stability of the United States.

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# Funeral Plans

***"Plans are worthless but planning is everything"***

***- Dwight D. Eisenhower***

**Tom Biron**

- The legislation requires **"resolution plans"** from the following:
    - Bank holding companies with total consolidated assets equal to or greater than $50 billion; and
    - Nonbank financial companies supervised by the Federal Reserve.
        - The Financial Stability Oversight Council may determine that a nonbank financial company shall be supervised by the Federal Reserve if the Council determines that material financial distress at such company could pose a threat to the financial stability of the United States.
- Judicial review under an arbitrary and capricious standard.
- Annual re-evaluation.

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# Funeral Plans: Requirements

***"No war is ever won according to plan,***
***but no battle is ever won without one"* – *Dwight D. Eisenhower***

**Tom Biron**

## Resolution Plan

- The company's road map for a rapid and orderly resolution in the event of material financial distress or failure.

## Credit Exposure Reports

- The company also must report periodically on (i) the nature and extent to which the company has credit exposure to other significant non-bank financial companies and significant bank holding companies and (ii) the nature and extent to which other significant bank holding companies have credit exposure to that company.

## Stress Tests

- Companies must take into account off-balance sheet activities.

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# Funeral Plans: Deficiencies

***"A good plan today is better than a perfect plan tomorrow"***

***– General George Patton Jr.***

**Tom Biron**

- If the Federal Reserve and the FDIC jointly determine that the resolution plan is not credible or would not facilitate an orderly resolution of the company, they shall notify the company of the deficiency and the company must revise and resubmit the resolution within a time frame to be determined.
  - Consequences of failure to timely resubmit a plan include:
    - More stringent capital, leverage or liquidity requirements, or restrictions on the growth, activities or operations of the company or its subsidiaries.
    - Ordered divestiture of assets and operations, or required bankruptcy case filing, if the company fails to resubmit a revised resolution within 2 years.

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# Funeral Plans:
# Early Remediation

**Tom Biron**

- The Federal Reserve shall establish requirements to provide for early remediation of financial distress.
  - **Purpose:** Minimize the probability that the company will become insolvent and the harm of such insolvency on financial stability of the US.
- **Requirements:**
  1. define measures of the financial condition of the company (e.g. liquidity, regulatory capital);
  2. establish more stringent requirements as the company's financial condition declines.

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# Orderly Liquidation Authority: FDIC as Receiver

**Tom Biron**

- The FDIC and Federal Reserve may recommend that the Treasury Secretary appoint the FDIC as receiver for a "covered financial company" or any covered broker or dealer.
- Liquidation authority should be exercised so
  - i. shareholders and creditors bear the losses of the company;
  - ii. management responsible for failure will not be retained;
  - iii. all responsible parties bear losses consistent with their responsibility.

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# Orderly Liquidation Procedures: FDIC's Powers & Duties

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- **Operation during liquidation,**
  - The FDIC may:
    1. take over the covered financial company's assets,
    2. collect all obligations and money owed to such company,
    3. perform all functions of such company,
    4. manage the assets and property of such company, and
    5. assist in fulfilling any function, activity, action or duty of the FDIC.

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# Orderly Liquidation Authority: FDIC's Powers &Duties

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- **Contract rights:** The FDIC may disaffirm or repudiate any contract or lease to which the company is a party within a "reasonable time." Liability of the FDIC is limited to actual direct compensatory damages.
  - The FDIC can enforce contracts of subsidiaries or affiliates of the financial company, guaranteed or otherwise linked to the financial company, notwithstanding any contractual right to terminate, liquidate, or accelerate the contract based solely on the financial condition, insolvency or receivership of the company, if the guaranty or support is transferred to and assumed by a bridge financial company or the FDIC otherwise provides adequate protection to contract counterparty.

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# Orderly Liquidation Authority: FDIC's Powers & Duties

**Tom Biron**

- **Avoidance:** The FDIC can avoid fraudulent transfers and preferential transfers.
  - Any legally enforceable or perfected security interest in any assets of the financial company is not avoidable by the FDIC.
- **Setoff rights:** Preserved except to the extent improved within 90 days before receivership.
  - Certain offsets before receivership avoided and recovered.

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Questions?

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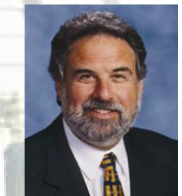

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