

# Dodd-Frank Wall Street Reform and Consumer Protection Act

## Preliminary Assessment of Provisions Effective Immediately or Very Soon After Enactment

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Today, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act. Congress has made a policy decision to stage the effectiveness of the law over time, giving financial institutions and other market participants the ability to prepare. A few sections, however, have immediate or near immediate effect.

The summary below describes these provisions. In general, the summary does not include provisions where rulemakers have immediate rulemaking authority, except those where we expect rulemakers to act quickly. It also reflects judgment calls where the legislative text is ambiguous as to whether rulemaking is required.

To be precise, some provisions of the Act take effect upon “enactment,” which is the day the President signs the Act into law. Other provisions, including those effective via the general effectiveness provision in Section 4 of the Act, however, take effect one day after enactment, except where a section specifically sets forth a later date. This structure, as well as some ambiguities in the text, make the date of enactment analysis more complex than is usual. Although we’ve identified these provisions as having “immediate” effect, many, such as the Financial Stability Oversight Council’s authority, will have delayed effect in practice due to logistical considerations.

For a summary of the Wall Street Reform and Consumer Protection Act, please see the [Davis Polk Memorandum](#) and the accompanying [Davis Polk Regulatory Implementation Slides](#).

### Changes Affecting Capital Markets Transactions

- **Change to Accredited Investor Standard.** The accredited investor net worth threshold will be \$1 million, excluding the value of the investor’s primary residence. The change implicates any private placement under Reg D that involves individuals as purchasers.
- **Elimination of Exemption for ABS.** The exemption from registration for certain categories of mortgage-backed securities provided for in Section 4(5) of the Securities Act is eliminated.
- **Regulatory Capital Treatment of TruPS.** Trust-preferred and hybrid securities issued on or after May 19, 2010 will be counted as Tier 2, not Tier 1 capital, regardless of the size of the issuer. We expect this to be a small group.
  - Of more importance for a wide range of bank holding companies with outstanding TruPS, issued before May 19, 2010 and benefitting from a phase-in, the Act’s passage is likely to be a “capital treatment event” under the terms of TruPS indentures and trustee agreements, which would, depending on the language, give the bank holding company that issued the TruPS the right to call them, at par, subject to regulatory approval. Issuers should carefully check the provisions in all of their outstanding TruPS now.
- **Credit Rating Agency Reform.** Certain reforms take effect immediately. This includes the rescission of Rule 436(g) under the Securities Act, with the effect that in order to include a credit rating agency’s credit rating in a registration statement or in a Section 10(a) prospectus, the registrants must file the credit rating agency’s consent along with the registration statement. It also includes the lowering of the requisite “state of mind” with respect to pleading requirements for private securities fraud actions for money damages against a credit rating agency or

controlling person. The rescission of Rule 436(g) may result in an increase in Rule 144A transactions.

- **Orderly Liquidation Regime.** The FDIC is given powers under the orderly liquidation authority immediately. While the FDIC and courts will have to engage in extensive rulemaking to establish the regime, the potential of future application of the regime will have an immediate effect on credit risk evaluations of customers and counterparties.
- **Sarbanes-Oxley Exemption for Nonaccelerated Filers.** Section 404 of the Sarbanes-Oxley Act is amended to exempt small issuers that are neither a large accelerated filer nor an accelerated filer from complying with the Section 404(b) internal control rules of Sarbanes-Oxley.

## Changes Affecting Growth Transactions

- **Large Nonbank Acquisitions.** Bank holding companies with \$50 billion or more in assets and, once designated, systemically important nonbank financial companies (referred to collectively, “**systemically important companies**”) must provide notice to the Federal Reserve before acquiring direct or indirect control of any voting shares in certain financial companies with \$10 billion or more in total consolidated assets.
- **Moratorium on “Bank” Exceptions to the BHCA.** The FDIC may not approve any application for deposit insurance, received after November 23, 2009, for an industrial bank, credit card bank or trust bank that is, directly or indirectly, owned or controlled by a commercial firm. Furthermore, the appropriate federal banking agency must disapprove any change in control that would result in direct or indirect control by a commercial company of an industrial bank, industrial loan company, credit card bank or trust bank, subject to certain exceptions. The moratorium sunsets after three years.
- **National Deposit Limit.** Subject to limited exceptions, all insured depository institutions and their holding companies are prohibited from engaging in interstate bank merger transactions if the resulting depository institution, including all depository institution affiliates, would control more than 10% of total U.S. insured deposits. Current law imposes the deposit cap on bank holding companies, but not on other insured depository institution holding companies.

## Derivatives Provisions

- **Certain Exempt Commodities.** Beginning on the date of enactment and ending 60 days after enactment, a person may submit a petition to the CFTC to remain subject to Commodity Exchange Act § 2(h) as is in effect on the day before enactment. The CFTC must consider any petition and may allow such treatment for not longer than 1 year. In general, Section 2(h) currently excludes from certain requirements of the Commodity Exchange Act certain transactions and activities in “exempt commodities,” meaning any commodity other than an agricultural or financial commodity.
- **Reporting of Pre-Enactment Swaps.** While, due to ambiguities in drafting,<sup>1</sup> it is not entirely clear, the Act would seem to require each of the SEC and CFTC to issue interim final rules within 90 days after enactment concerning reporting of pre-enactment swaps that are not accepted for

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<sup>1</sup> There is ambiguity regarding the time frame for the effectiveness of these reporting requirements (Sections 729 and 766), as well as the relationship between these provisions and other provisions (Sections 723 and 763) which appear to require agency rulemaking concerning the reporting of pre-enactment swaps on a different time frame. A Senate colloquy has referred to these provisions and stated that they should be interpreted as complementary but did not otherwise provide guidance.

clearing. Each swap entered into before the date of enactment whose terms have not expired as of the date of enactment must be reported by a date not later than 30 days after the date of such interim final rules or such other period determined by the relevant regulator.

## Immediate Systemic Regulation

- **Imposition of Stricter Standards.** In theory, the Federal Reserve could apply higher prudential standards on any bank holding company with assets of \$50 billion or more the day after enactment. We expect that there will be a delay while the new regulations are put in place, but a shift in policy attitude could happen quickly. No designation is necessary for imposition of stricter standards and no appeal procedure is created by the Act.
- **Systemically Important Designation for Nonbank Financial Companies.** As soon as the Financial Stability Oversight Council (the “**Council**”) is operational, it has the power to designate nonbank financial companies as systemically important and has the power, acting through the Office of Financial Research (the “**OFR**”), to collect reports from any bank holding company or nonbank financial company for the purpose of determining whether the company poses a threat to U.S. financial stability. Furthermore, the Council may, if necessary, request that the Federal Reserve conduct an examination of a U.S. nonbank financial company for the sole purpose of determining whether to designate the company.
  - We expect the Council to be active in the early stages in collecting reports through the OFR to inform its designations.
  - Companies identified for potential designation will have notice and appeal rights. Once designated, a company will be subject to regulation by the Federal Reserve, which will include new registration, examination, and reporting requirements, and heightened prudential standards, which may not be in place at the time of designation.
  - Upon designation, systemically important nonbank financial companies will be treated as bank holding companies for purposes of the acquisition limits in Section 3 of the Bank Holding Company Act.
- **Break-Up Upon a “Grave Threat.”** Subject to notice and hearing rights and with 2/3 vote of the Council, the Federal Reserve has authority to impose conditions on any activity of a systemically important company, and as a last resort, require the company to dispose of assets, if it determines that the company poses a “grave threat” to U.S. financial stability.
- **Systemically Important Payment, Clearing and Settlement Systems.** As soon as it is operational, the Council may designate a financial market utility or a payment, clearing or settlement activity as systemically important. The Council may request information from any financial market utility or financial institution for purposes of determining whether the utility or financial institution’s payment, clearing, and settlement activities are systemically significant. Financial market utilities and activities so designated will have notice and appeal rights.
  - The regulation could reach a wide scope of back office activities, including holding customer positions in street name.
- **“Hotel California” (De-Banking).** A bank holding company with \$50 billion or more in assets that received TARP assistance automatically becomes a systemically important nonbank financial company if it subsequently de-banks, although an appeal procedure is available.
- **Management and Director Interlocks Prohibition.** Systemically important nonbank financial companies will be subject to a prohibition on management and director interlocks as if they were bank holding companies, and the Federal Reserve may not permit management interlocks

between unaffiliated systemically important companies, other than on a temporary basis in the case of a merger, acquisition or consolidation.

- This may immediately affect selection of management and directors of bank holding companies with assets of \$50 billion or more to the extent interlocks exist with nonbank financial companies expected to become systemically important.

## New Examination and Enforcement

- **FDIC Examinations.** The FDIC is authorized to conduct special examinations of systemically important companies for the purpose of implementing its authority under the orderly liquidation regime, provided that such authority may not be used with respect to a company that is in a generally sound condition.
  - The FDIC indicated its readiness to exercise this power in its interagency [memorandum of understanding](#) issued July 9, 2010, which broadened the scope of its special examination power.
- **FDIC Enforcement.** The FDIC is authorized to recommend enforcement action against a depository institution holding company to the appropriate Federal banking agency if the conduct or threatened conduct of the depository institution holding company poses a risk to the Deposit Insurance Fund, and the FDIC is granted back-up authority if such agency does not act.

## Fees and Changes to Deposit Insurance

- **Fees**
  - There is no longer an upper limit for the reserve ratio designated by the FDIC each year. The minimum designated reserve ratio may not be less than 1.35% (raised from 1.15%) of insured deposits. While the FDIC will have to take action in order to increase assessments, we expect the FDIC to act quickly.
  - The Act imposes a floor on assessments paid by SIPC members at 0.02% of the gross revenues from the securities business. The SIPC assessment is currently 0.25% of gross revenues, so this change will not have immediate practical effect. As recently as March 2009, however, the fee was a flat \$150 per member.
  - Under prior law, if the reserve ratio exceeded 1.5%, the FDIC was required to pay dividends to member institutions equal to the amount the fund exceeded the 1.5% level. If the reserve ratio was greater than 1.35%, but less than 1.5%, the FDIC was required to pay dividends equal to half the amount by which the reserve ratio exceeded 1.35%. Both requirements are eliminated. This provision will have little practical effect in the near-term because the reserve ratio is currently negative.
- **Increased Deposit Insurance**
  - The maximum amount of deposit insurance is permanently increased to \$250,000 with retroactive effect to January 1, 2008.
  - The cash limit on SIPC protection is increased from \$100,000 to \$250,000, subject to periodic adjustments for inflation.

## Investor Protection and Changes to the Regulation of Securities

- **Streamlining Filing Procedures for SROs.** SRO rule filings will be deemed filed, noticed, and approved if the SEC does not respond within short deadlines. Market data fees will take effect on filing.

- **Securities Lending Notices.** Every registered broker-dealer must provide notice to its customers that they may elect not to allow their fully paid securities to be used in connection with short sales and that the broker-dealer may receive compensation in connection with lending the customer's securities.
- **Exemption for Equity Indexed Annuities.** Subject to certain conditions, the SEC must treat as exempt securities under the Securities Act any insurance or endowment policy, annuity contract or optional annuity contract issued by an insurance company.
- **Expanded Whistleblower Protection.** Subsidiaries and affiliates that are consolidated with public companies for financial accounting purposes will be subject to the whistleblower protections in Sarbanes-Oxley.
- **Nationwide Service of Subpoenas.** The SEC may serve subpoenas nationwide in civil actions filed in federal courts.
- **Authority Over Formerly Associated Persons.** The SEC may bring suits against persons formerly associated with a registered entity to prevent individuals from evading a penalty or other remedial action.
- **Expanded Application of Anti-Fraud Provisions.** The Exchange Act's anti-fraud provisions cover, among others, any security other than a government security, as opposed to just exchanged-listed securities.
- **Aiding and Abetting.** The mental state for aiding and abetting actions includes "recklessness."
- **Penalties in Cease and Desist Proceedings.** The SEC can uniformly seek civil penalties in cease and desist proceedings.
- **Control Person Liability.** The SEC may impose joint and several liability on control persons.
- **Deadline for Completing Examinations, Inspections and Enforcement Actions.** An SEC enforcement action must be filed within 180 days after the SEC has sent a written Wells notification, and the SEC must notify the company within 180 days of the SEC's completion of its on-site examination whether any corrective action will be required. In both cases, an extension is available for complex matters.

### Institutional Changes

- **Council Established.** The Council is established, consisting of 10 voting members and 5 nonvoting members. Although technically created upon enactment, the Council will not be operational for some time as two of the voting members and one of the nonvoting members must be appointed by the President and confirmed by the Senate, and another three of the nonvoting members must be appointed by a process to be determined by state regulators.
  - **Council of Inspectors General.** The Council of Inspector's General is established and is authorized to form a working group to evaluate the effectiveness and the internal operations of the Council.
  - **Council's Information-Gathering Authority.** The Council has information gathering powers described above.
- **OFR Established.** The OFR is established, but its director must be appointed by the President and confirmed by the Senate. The OFR will operate a Data Center and a Research and Analysis Center, which will publish databases of financial companies and financial instruments in a manner that is easily accessible to the public. The OFR will also collect financial transaction and position data, which will include information that identifies counterparties and allows the OFR to make an

independent valuation of the financial asset in question. While the OFR is instructed to maintain the confidentiality of all data, such data is also subject to FOIA.

- **FIO Established.** The Federal Insurance Office (the “**FIO**”) is established within the Treasury, with the director to be appointed by the Treasury Secretary.

## Regulation of Depository Institutions and Their Holding Companies

- **De Novo Interstate Branching.** The Act permits de novo interstate branching by national banks and insured state banks.
- **Credit Card Bank and Small Business Lending.** A credit card bank may make credit card loans to certain small businesses while still retaining its “bank” exemption under the Bank Holding Company Act.
- **Thrift Branches.** A thrift that converts to a bank is permitted to retain its branches and to establish additional branches within states where it operated a branch prior to becoming a bank to the same extent permitted to state-chartered banks in such states by applicable state law.
- **Qualified Thrift Lenders.** A thrift that fails to become or remain a qualified thrift lender will be subject to certain remedial actions, including dividend restrictions.
- **Broadened Lending for Small Businesses.** The Act amends the Bank Holding Company Act to permit a credit card bank to make credit card loans to small businesses that are eligible for loans under regulations issued by the Small Business Administration, while still retaining its exemption from the term “bank” under the Bank Holding Company Act.

## Consumer Protection

- **Consumer Financial Protection Bureau Established.** The Bureau of Consumer Financial Protection (the “**Consumer Bureau**”) is established as an Executive agency within the Federal Reserve.
- **Rulemaking Authority; Supervision of Nondepository Covered Persons.** Under a literal reading of the text, the Consumer Bureau is immediately granted rulemaking authority and, with respect to nondepository covered persons (e.g., mortgage brokers, private educational lenders and payday lenders), the authority to examine and to enforce rules. It is not clear at this stage how this immediately effective authority interacts with the transfer of consumer protection functions of other agencies that is not to occur until 6 to 18 months after enactment.
  - Regardless of the ambiguity surrounding the effective date of the Consumer Bureau’s various authorities, we do not expect that the Consumer Bureau will be active for some months. The Director must be appointed by the President and confirmed by the Senate, a process that could take months. Following confirmation, the Director must assemble a staff and secure transitional funding from the Federal Reserve, another lengthy process.

## Executive Compensation

- **Broker Discretionary Voting.** The listing exchanges must prohibit broker discretionary voting in connection with the election of directors, executive compensation, or any other significant matter, as determined by the SEC.
- **Say on Pay and Golden Parachutes.** At an annual or other meeting of shareholders held 6 months after the date of enactment, companies must provide their shareholders with (1) a vote on executive compensation as disclosed, (2) a vote to determine whether a say on pay vote must be held annually or every two or three years and (3) a vote on golden parachutes for M&A transactions.

## Foreign Activities

- **Foreign Bank Offices in the U.S.** The Federal Reserve is authorized to terminate the activities of a U.S. branch, agency or commercial lending company of a foreign institution that presents a systemic risk to the U.S., if the Federal Reserve determines that the home country has not adopted or made progress towards adopting appropriate regulation to mitigate such risk.
- **Foreign Broker-Dealers.** In determining whether to permit a foreign person or an affiliate to register as a U.S. broker-dealer or succeed to the registration of a U.S. broker-dealer, the SEC may consider whether a foreign person or its affiliate presents a risk to the stability of the U.S. financial system, and may take into account whether the home country adopts an appropriate system of financial regulation to mitigate this risk.
- **Extraterritoriality.** The jurisdictional reach of the anti-fraud provisions is extended, but only with respect to actions by the U.S. or the SEC. Extraterritoriality is extended to “conduct within the U.S. that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the U.S. and involves only foreign investors” as well as “conduct occurring outside the U.S. that has a foreseeable substantial effect within the U.S.”

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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