

October 2009

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## Congress Builds on Obama Financial Regulatory Reform Approach, as Reform Efforts Proceed

Congress continues to move forward expeditiously on the financial services regulatory reform effort. Over the past several weeks, House Financial Services Committee Chairman Barney Frank (D-MA), in conjunction with other key committee members, has released additional legislative proposals building on the Obama Financial Regulatory Reform plan, while Senate Banking Committee Chairman Chris Dodd (D-CT) and Ranking Member Richard Shelby (R-AL) develop a separate regulatory reform package. At the same time, these Committees have kept up a remarkably ambitious hearing schedule. This update provides an overview of significant recent developments, as well as the outlook moving forward.

### Regulatory Reform Developments

#### Consumer Financial Protection Agency

On October 9, Chairman Frank released a [Manager's Amendment](#) to the Consumer Financial Protection Agency (CFPA) bill. Chairman Frank had released a discussion draft bill, on which the Manager's Amendment is based, on September 22. His original bill, [H.R. 3126](#), was introduced July 8 and was based largely on the Administration's proposed "[Consumer Financial Protection Agency Act of 2009](#)."

The amendment and discussion draft, whose approaches have been endorsed by Treasury Secretary Timothy Geithner, modify key aspects of the proposal in an effort to respond to industry and bank regulators' concerns. Some of the changes include:

- Removing the requirement that financial institutions offer "plain vanilla" products and/or services;
- Clarifying which entities would be regulated by the CFPA and clearly exempting non-financial businesses, *e.g.*, retailers, from CFPA oversight;
- Eliminating the requirement that communications with consumers be "reasonable";
- Providing a stronger focus on non-depository institutions, including enhanced registration, reporting, and examination requirements; and
- Enhancing coordination between the CFPA and banking regulators.

However, critics continue to be concerned about aspects of the discussion draft, particularly the body's broad rule-making authority, persistent regulatory overlap between the CFPA and banking regulators, and the elimination of federal preemption of state and local laws. The House Financial Services Committee held a [hearing](#) on the legislation on September 30 and is scheduled to hold a [markup](#) on October 14.

As noted previously, in the Senate, Chairman Dodd has been working with Ranking Member Shelby to reach agreement on various aspects of the regulatory reform

legislation, in an effort to gain Republican support for the final package. However, the two have diverged on the issue of the CFPA. While Chairman Dodd has endorsed the Obama Administration's approach, Ranking Member Shelby has echoed many of the industry and bank regulators' concerns.

### Credit Rating Agencies

On September 25, House Financial Services Capital Markets Subcommittee Chairman Paul Kanjorski (D-PA) released a [discussion draft](#) of legislation to create the "Enhanced Accountability and Transparency in Credit Rating Agencies Act." The discussion draft is largely based in part on the Obama Administration's proposed draft legislation on rating agencies, [Subtitle C](#) of the "Investor Protection Act of 2009," which was released July 21. The Capital Markets Subcommittee held a [hearing](#) on credit rating agency reform on September 30.

At its August 5 [hearing](#) on credit rating agency reform, some Senate Banking Committee members raised concerns that the Obama Administration's reform proposal did not include strong enough protections, particularly because it required disclosure, rather than performance, of due diligence from agencies. In May, Senate Banking Securities Subcommittee Chairman Jack Reed (D-RI) introduced S. 1073, the "Rating Accountability and Transparency Enhancement Act of 2009." Notably, Chairman Kanjorski's discussion draft includes a provision, originally contained in S. 1073, that provides investors with a right of action against agencies that "knowingly or recklessly" overlook significant information when determining ratings.

For additional information regarding credit rating agency reforms, please see the K&L Gates alert [Sweeping Reforms of Credit Rating Agency Practices Move Forward](#).

### Private Adviser Registration, Investor Protection, National Insurance Office

On October 1, Chairman Kanjorski released discussion drafts on three aspects of the regulatory reform proposal, the [draft "Investor Protection Act"](#), the [draft "Private Fund Investment Advisers Registration Act"](#), and the [draft "Federal Insurance Office Act"](#). Chairman Kanjorski noted that the

discussion drafts "significantly enhance" the draft legislation released by the Obama Administration in July (see [Subtitles A and B](#) of the "Investor Protection Act of 2009," the "[Private Fund Investment Advisers Registration Act of 2009](#)," and the "[Office of National Insurance Act of 2009](#)").

Significant aspects of Chairman Kanjorski's draft "Investor Protection Act" include:

- Creating a fiduciary duty for brokers, dealers, and investment advisers "to act in the best interest of the customer without regard to [compensation]," including those providing investment advice to a retail customer. However, the receipt of compensation based on commission shall not, in and of itself, be considered a violation of such standard.
- Clarifying SEC authority to require disclosures to mutual fund investors prior to sale.
- Requiring annual testimony by the SEC, FASB, and PCAOB on their efforts to reduce complexity of financial reporting.
- Permitting the SEC to restrict mandatory predispute arbitration.
- Creating authority for the SEC to impose civil money penalties in cease and desist proceedings in three tiers: (1) act or omission, (2) fraud or reckless disregard, and (3) substantial loss; in addition, authorizing prosecution for aiding and abetting to the same extent as the person to whom such assistance is provided.
- Creating whistleblower incentives (30 percent of monetary sanctions exceeding \$1 million) and protections.

The draft "Private Fund Investment Advisers Registration Act" would require private advisers to hedge funds and other private pools of capital to register with the SEC. The private advisers would also be subject to new recordkeeping and disclosure requirements. Notably, unlike the Obama Administration's proposal, Chairman Kanjorski's discussion draft would exempt advisers of venture capital funds from the registration requirement (but not the recordkeeping or reporting requirements), a point of controversy during the October 6 hearing.

The objective of the draft “Federal Insurance Office Act” is to create a new Office of National Insurance at the Treasury Department, which will be responsible for aggregating state insurance data. It is likely the legislation is a placeholder, deferring significant insurance industry reforms until the next Congress.

### **Over-the-Counter (OTC) Derivatives**

On October 2, Chairman Frank released a [discussion draft](#) of the “Over-the-Counter Derivatives Markets Act of 2009.” Shortly thereafter, on October 9, House Agriculture Committee Chairman Collin Peterson (D-MN) released a [discussion draft](#) of the “Over-the-Counter Derivatives Markets Act of 2009.” The two Chairmen had previously released a joint [Concept Paper](#) to guide the two committees as they develop legislation to regulate derivatives.

On October 7, the House Financial Services Committee held a [hearing](#) on its discussion draft, which is generally less restrictive than the Obama Administration’s [proposal](#) released on August 11. At the hearing, Gary Gensler, the Chairman of the CFTC, and Henry Hu, the Director of the SEC Division of Risk, Strategy, and Financial Innovation, raised several objections to Chairman Frank’s discussion draft. One of the central issues remains the central clearing and exchange trading of standardized contracts. Chairman Frank is redrafting the discussion draft to address some of Mr. Gensler and Mr. Hu’s concerns, while leaving concerns that fall under the House Agriculture Committee to Chairman Peterson.

The House Financial Services Committee will hold a markup of the discussion draft on October 14.

### **Other Issues**

Both the House Financial Services Committee and the Senate Banking Committee are continuing work on other aspects of the regulatory reform effort. Chairman Frank continues to draft legislation pertaining to systemic risk, which includes proposals such as the Financial Services Oversight Council (FSOC) and Federal Reserve regulation of Tier 1 Financial Holding Companies. He is also working on legislation to abolish the Office of Thrift Supervision (OTS) and to create the National Banking Supervisor (NBS). In the Senate, Chairman

Dodd has indicated support for different approaches than those espoused by the Obama Administration and Chairman Frank, including providing more systemic risk oversight authority to the FSOC rather than the Federal Reserve and further consolidation of federal bank supervisors beyond a merger of the OCC and OTS. Please see the [House Financial Services Committee website](#) and the [Senate Banking Committee website](#) for further information on the hearings that have been held on these topics.

In addition, both Committees continue to consider securitization. The House Financial Services Capital Markets Subcommittee held a September 24 [hearing](#) and the Senate Banking Securities Subcommittee held an October 7 [hearing](#) on the topic.

### **Looking Ahead**

As noted previously, the House Financial Services Committee will be marking up and holding Committee votes on various aspects of the House reform package during the week of October 12. Chairman Frank continues to plan to move legislation to the House floor this fall. Chairman Dodd, in conjunction with Ranking Member Shelby, continues to put together a separate Senate package. Earlier this month, Chairman Dodd noted that he hopes to have the legislation on the Senate floor before Thanksgiving; however, the legislation is not expected to be considered until 2010. Ultimately, the differences between the House and Senate versions will be reconciled in conference committee, a process largely shielded from public scrutiny.

Please see previous K&L Gates updates, including [House and Senate Take Expedited But Divergent Approaches to Financial Regulatory Reform Plan](#) and [Eye of the Storm: A Summer Recess Assessment of the Capital Markets Reform Effort](#) for additional information about the reform effort. In addition, please see the K&L Gates [Global Financial Market Watch Blog](#) for detailed analysis on many of the Obama proposals and future updates.

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