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Eye of the Storm: A Summer Recess Assessment of the Capital Markets Reform Effort

Since June 17, 2009, when the Obama Administration unveiled its [financial regulatory reform plan](#), there has been a flurry of executive branch and legislative branch activity. The frenetic pace of the reform effort is expected to resume in the fall, as Congress works to resolve the many highly controversial issues presented by the plan. The traditional August Congressional recess now underway provides an opportunity to take stock of this historic capital markets reform effort. This alert provides an overview of the most significant developments so far, as well as the outlook moving forward.

Fleshing Out the Details

In recent weeks, the Obama Administration has released several rounds of proposed legislative language, filling in the details of its financial regulatory reform plan (for details about the plan, see K&L Gates Alerts [The Obama Plan for Financial Services Regulatory Reform: A New Foundation or An Ambitious Renovation?](#) and [Capital Markets Reform: The Marathon Starts with a Sprint](#)). In certain cases, the Administration's release of its proposed legislative language has been quickly followed by Congressional introduction of legislation that is largely similar, suggesting a high degree of coordination between the White House and Capitol Hill. In brief, the legislative proposals so far include:

- On July 8, House Financial Services Committee Chairman Barney Frank (D-MA) introduced [H.R. 3126](#), which mirrors the Administration's proposed "[Consumer Financial Protection Agency Act of 2009](#)." The legislation would create the Consumer Financial Protection Agency (CFPA) to promote transparency, simplicity, fairness, and accountability for consumer financial products and services, other than those regulated by the SEC and the CFTC. Chairman Frank stated that he intends to mark up the bill after the August recess, giving consumer advocates time to lobby for the bill. For additional information, see K&L Gates Alerts [Million Dollar Baby: The Consumer Financial Protection Agency Act of 2009](#) and [Singularity of Purpose: Is Looking Out for Consumers Too Narrow a Mission?](#)
- On July 10, the Administration released proposed legislative language, [Subtitles A and B](#) of the "Investor Protection Act of 2009," which would enhance the Securities and Exchange Commission's (SEC) investor protection authorities, thereby complementing the CFPA legislation. In particular, the Act would establish a fiduciary duty for brokers, dealers and investment advisers and authorize the SEC to harmonize the regulation of such financial intermediaries. Among other things, it also gives the SEC the authority to restrict mandatory pre-dispute arbitration, protects whistleblowers and establishes the "SEC Investor Protection Fund" to pay awards to whistleblowers and to fund investor education initiatives.

- On July 15, the Administration released the “[Private Fund Investment Advisers Registration Act of 2009](#).” The proposed legislative language would generally require advisers to hedge funds and other private pools of capital, including advisers to private equity funds and venture capital funds, to register with the SEC under the Investment Advisers Act of 1940. Previously, on June 16, Senate Banking Committee Securities Subcommittee Chairman Jack Reed (D-RI) introduced [S. 1276](#), a similar bill requiring private fund advisers to register. For additional information, see K&L Gates Alert [The Obama Administration’s Proposal for the Registration of Investment Advisers to Private Investment Funds: The Private Fund Investment Advisers Registration Act of 2009](#).
- The Administration, on July 21, released its credit rating agency reform proposal. [Subtitle C](#) of the “Investor Protection Act of 2009” would enhance the SEC’s supervisory authority over credit rating agencies, and increase transparency over the agencies and rating process. This proposed legislation would replace the current voluntary registration system with mandatory registration with the SEC of all credit rating agencies. The proposed bill would also bring about significant adjustments in the manner in which these agencies are compensated, with an emphasis on a new system of payment that structures payment over time based on the reliability of the agencies’ ratings. For additional information, see the upcoming K&L Gates Alert on credit rating agency reform.
- The Administration’s proposed systemic risk legislation was sent to Capitol Hill on July 22, 2009. The proposal would create a Financial Services Oversight Council to facilitate coordination of financial regulatory policy and resolution of disputes and identify emerging risks in financial markets. In addition, the Federal Reserve would be given the authority to supervise and regulate all financial firms that are found to pose a threat to financial stability based on their size, leverage, and interconnectedness to the financial system. Under the proposal, such “Tier 1 FHCs” will be subject to consolidated supervision and regulation, including Federal Reserve examination of subsidiaries. For additional information, see K&L Gates Alert [A New Playing Field for the Banking Industry: The National Banking Supervisor and Systemic Risk](#).
- On July 23, the Administration proposed the “[Federal Depository Institutions Supervision and Regulation Improvements Act of 2009](#),” the “[Payment, Clearing, and Settlement Supervision Act of 2009](#),” and the “[Resolution Authority for Large, Interconnected Financial Companies Act of 2009](#).” The legislation would create a National Bank Supervisor through the consolidation of the Office of Thrift Supervision (OTS) and the Office of the Comptroller of the Currency (OCC), and would also eliminate the thrift charter and thrift holding company framework. In addition, the legislation would provide the government with emergency authority to resolve any large, interconnected financial firm. For additional information, see K&L Gates Alert [A New Playing Field for the Banking Industry: The National Banking Supervisor and Systemic Risk](#).
- On July 30, House Financial Services Chairman Barney Frank (D-MA) and House Agriculture Chairman Collin Peterson (D-MN) presented a [concept paper](#) on how to regulate over-the-counter (OTC) derivatives. The concept paper includes seven key principles for Federal legislation of OTC derivatives trading: robust oversight of dealers and markets; mandatory clearing of OTC derivatives, with exceptions; strengthening capital and margin requirements; reining in certain types of speculation; preventing regulatory arbitrage; establishing a Financial Services Oversight Council that would promptly resolve disputes; and enforcement of new and existing laws and regulations governing OTC derivatives. The wholesale rethink of OTC derivative practices and market structure has been a principal feature of the Obama Administration’s Financial Regulatory Reform mandate.

- Congressman Michael McMahon (D-NY), along with thirteen co-sponsors, recently introduced [H.R. 3300](#), the most comprehensive bill on OTC derivatives trading and exchanges to date. H.R. 3300, the “Derivative Trading Accountability and Disclosure Act,” is generally consistent with a Frank-Peterson concept paper. For additional information, see K&L Gates Alert [OTC Derivatives Legislation Continues to Take Form](#).
- On July 31, just before departing for the summer recess, the House passed [H.R. 3269](#), the “Corporate and Financial Institution Compensation Fairness Act of 2009,” based largely on the Administration’s legislative proposals on “[say-on-pay](#)” and [compensation committees](#). As the Senate moves forward, it could adopt one of two approaches. [S. 1074](#), introduced by Senator Charles Schumer (D-NY), takes a holistic approach by including additional corporate governance provisions, such as eliminating staggered boards and dividing the duties between the board chairman and CEO. Alternatively, Senate Banking Committee Chairman Christopher Dodd (D-CT) introduced a bill in the last Congress that focused primarily on say-on-pay. For additional information, see K&L Gates Alert [The Economic Crisis: Broader Executive Compensation Reforms Coming Soon](#).

The rapid pace at which the reform proposals have been released has been matched with equally ambitious Committee hearing schedules. Over the past several weeks, the House Financial Services Committee has held more than a dozen hearings or markups on a variety of issues.ⁱ The Senate Banking Committee has also had an active schedule.ⁱⁱ Both Committees will continue hearings and markups in the fall, after Congress returns from its August recess.

Outlook

At a National Press Club (NPC) speech on July 27, 2009, Chairman Frank observed that the regulatory framework has not kept up with innovations in financial products and services. The resulting

problem has been “non-regulation” (as opposed to deregulation) and the objective of the regulatory reform proposals is to mitigate the risks associated with these innovations. In this context, Chairman Frank has said that the proposal to create the CFPA will move forward soon, with some minor modifications. However, in recent weeks, the proposal has attracted increasing opposition from the financial services industry and also the Federal Reserve, which argues that it should retain control of consumer protection oversight. One possible compromise could be to give rulemaking authority to the CFPA, while keeping examination and compliance responsibilities with the banking regulators. In any case, it is likely that any compromise will maintain the SEC and CFTC carveout as proposed by the Administration, allowing both entities to continue oversight of issues already under their jurisdiction.

Another area of disagreement is the systemic risk architecture. As noted above, the Administration proposes to give the Federal Reserve responsibility for supervision and regulation of large, interconnected firms, while the Financial Services Oversight Council develops and coordinates systemic risk policy. FDIC Chairman Sheila Bair has instead suggested a framework in which the Financial Services Oversight Council would have stronger oversight authority and would work in concert with existing regulators. Both proposals have attracted criticism from Congress, as Members have been skeptical of the ability of the Federal Reserve or the proposed Council to function in these roles. Clearly, that debate has yet to be resolved.

During his NPC speech, Chairman Frank stated that he expects the House to vote on the regulatory reform proposals in September or October, with Senate consideration expected soon thereafter. He noted that the goal is to have the reforms signed into law by President Obama by the end of the year. Despite Chairman Frank’s ambitious timeline, it seems likely that Congressional consideration of the regulatory reform proposals will ultimately play out in fits and starts as other legislative priorities come into play. For example, the health care reform debate has been postponed to the fall, after the House recessed without holding a floor vote and the Senate recessed without the Senate Finance Committee, which has jurisdiction over substantial

portions of the health care bill, having come to an agreement. In addition, the Senate deferred much of its consideration of the climate change legislation until after Labor Day.

Certain pieces of the reform proposal, particularly with respect to federal regulation of insurance or harmonization of securities and futures regulation, seem calculated to extend the discussion into next year or even the next Congress. Finally, it must be noted that members of the Financial Crisis Inquiry Commission (FCIC) were appointed on July 15. The FCIC is modeled after the Great Depression-era Pecora Commission that led to enactment of the 1933 Securities Act and the 1934 Securities Exchange Act. Former California State Treasurer Phil Angelides was appointed as chairman, and former House Ways and Means Committee Chairman Bill Thomas was appointed vice chairman. The other FCIC members are: Brooksley

Born, John Thompson, Bob Graham, Heather Murren, Byron Georgiou, Peter Wallison, Doug Holtz-Eakin, and Keith Hennessey. The FCIC is to issue its report and recommendations to Congress in December, 2010. Therefore, regardless of the outcome on the pending proposals, more reforms are sure to come.

In order to address these unprecedented changes, K&L Gates has established a Capital Markets Reform Group that consists of designated partners in each of the firm's relevant practice areas across the full spectrum of capital markets issues. By coordinating across all of these disciplines, K&L Gates will be able to provide unequaled service and insights to firm clients as these new laws and implementing regulations are written (see K&L Gates Newsstand [K&L Gates Launches Capital Markets Reform Group](#)).

ⁱ Witness testimony is available by clicking the hyperlinks.

- July 28: [H.R. 3269, Corporate and Financial Institution Compensation Fairness Act of 2009](#)
- July 24: [Regulatory Perspectives on the Obama Administration's Financial Regulatory Reform Proposals-Part Two](#)
- July 22: [Regulatory Perspectives on the Obama Administration's Financial Regulatory Reform Proposals](#)
- July 21: [Systemic Risk: Are Some Institutions Too Big to Fail and If So, What Should We Do About It?](#)
- July 17: [Industry Perspectives on the Obama Administration's Financial Regulatory Reform Proposals](#)
- July 16: [Regulatory Restructuring: Safeguarding Consumer Protection and the Role of the Federal Reserve](#) (Domestic Monetary Policy and Technology Subcommittee)
- July 15: [Banking Industry Perspectives on the Obama Administration's Financial Regulatory Reform Proposals](#)
- July 10: [A Review of the Administration's Proposal to Regulate the Over-the-Counter Derivatives Market](#)
- July 9: [Regulatory Restructuring: Balancing the Independence of the Federal Reserve in Monetary Policy with Systemic Risk Regulation](#) (Domestic Monetary Policy and Technology Subcommittee)
- July 6: [Community and Consumer Advocates' Perspectives on the Obama Administration's Financial Regulatory Reform Proposals](#)

- June 25: [Improving Consumer Financial Literacy under the New Regulatory System](#) (Financial Institutions and Consumer Credit Subcommittee)
- June 24: [Regulatory Restructuring: Enhancing Consumer Financial Products Regulation](#)
- June 18: [The Administration's Plan for the Restructuring of the American Financial Regulatory System](#)

ⁱⁱ Witness testimony is available by clicking the hyperlinks.

- August 5: [Examining Proposals to Enhance the Regulation of Credit Rating Agencies](#)
- August 4: [Strengthening and Streamlining Prudential Bank Supervision](#)
- July 29: [Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance](#)
- July 28: [Regulatory Modernization: Perspectives on Insurance](#)
- July 23: [Establishing a Framework for Systemic Risk Regulation](#)
- July 15: [Regulating Hedge Funds and Other Private Investment Pools](#)
- July 14: [Creating a Consumer Financial Protection Agency: A Cornerstone of America's New Economic Foundation](#)
- June 22: [Over-the-Counter Derivatives: Modernizing Oversight to Increase Transparency and Reduce Risks](#)
- June 18: [The Administration's Proposal to Modernize the Financial Regulatory System](#)

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