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Redoubling Efforts on the Financial Reform Debate: House Approaches Floor Vote, While Senate Gets Underway

Over the past several weeks, Congress has accelerated the financial regulatory reform effort, which will dramatically restructure the legislative and regulatory framework that governs the financial services industry. Late last week, House Financial Services Committee (“HFSC” or “Committee”) Chairman Barney Frank (D-MA) announced that the Committee will complete its markup of the financial regulatory reform bills by November 20. In December, we expect the House to consider the following bills:

- The Financial Stability Improvement Act (HFSC consideration pending)
- The Investor Protection Act (HFSC passed on 11/4/09)
- The Accountability and Transparency in Rating Agencies Act (HFSC passed on 10/28/09)
- The Private Fund Investment Advisers Registration Act (HFSC passed on 10/27/09)
- The Consumer Financial Protection Act (HFSC passed on 10/22/09; House Energy and Commerce Committee passed on 10/29/09)
- The Over-the-Counter Derivatives Markets Act (HFSC passed on 10/15/09; House Agriculture Committee passed on 10/21/09)

Significantly, the Committee only began marking up the regulatory reform legislation, which is comprised of seven bills, on October 14 (in late July, the House also passed an additional bill, H.R. 3269, the “Corporate and Financial Institution Compensation Fairness Act of 2009,” as part of the regulatory reform effort).

As the House approaches floor consideration of the regulatory reform package, the Senate is getting underway with its parallel effort. Senate Banking Committee Chairman Chris Dodd (D-CT), who until recently had been working in conjunction with Ranking Member Richard Shelby (R-GA), released a single large [discussion draft](#) on November 10. Please see the upcoming K&L Gates alert on the Senator Dodd’s discussion draft for further details.

House

Systemic Risk, Bank Holding Company Regulation

On November 4, the HFSC began marking up the last significant piece of the regulatory reform package, the “Financial Stability Improvement Act” (“FSIA”; H.R. 3996; see [Committee Print](#)). FSIA is a lengthy document, combining and altering eight separate pieces of the Obama Administration’s legislative proposal issued over

the summer ([Title I](#), [Title II](#), [Title III](#), [Title VI](#), [Title VIII](#), [Subtitle E of Title IX](#), [Title XII](#), and [Title XIII](#)).

Among other things, FSIA would:

- Create a Financial Services Oversight Council (“FSOC”) to monitor systemic risks;
- Consolidate holding company regulation and subject additional institutions to regulation as bank holding companies, such as those owning non-bank institutions like industrial loan companies (“ILCs”) or credit card banks (unlike the Obama Administration’s proposal, which would have eliminated most non-bank institutions);
- Merge the Office of Thrift Supervision (“OTS”) into a division of the Office of the Comptroller of the Currency (“OCC”), while preserving the thrift charter (contrary to the Obama Administration’s proposal, which would have abolished the thrift charter and merged the OTS and OCC to form the new National Bank Supervisor);
- Subject firms or activities that pose significant risks to the financial system to heightened regulations (these firms, previously called “Tier 1 Financial Holding Companies” under the Obama Administration’s proposal, are now known as “identified financial holding companies”);
- Provide resolution authority for non-bank financial institutions; and
- Require credit risk retention.

At the time of this writing, Chairman Frank had limited the markup to “non-controversial” amendments, intending to address more difficult issues during the week of November 16. Areas of controversy include:

- Funding the new resolution authority: FSIA initially included a proposal to fund the resolution authority through an assessment on all financial institutions with assets over \$10 billion, which would be assessed after the use of the resolution authority. A number of

Committee Democrats have raised concerns with this approach and have instead proposed a pre-assessed Resolution Fund.

- Scope of “financial company” and “identified financial holding company”: There is significant controversy over the scope of the term “financial company” and the process of assessing whether an institution is an “identified financial holding company.”
- Powers of the Board of Governors of the Federal Reserve System (“Federal Reserve”).
- Whether FSOC will have authority to trump accounting standards.

Chairman Frank has said he hopes to complete the markup by November 20.

Investor Protection

On November 4, the HFSC reported favorably the “Investor Protection Act” (“IPA”; H.R. 3817; see [discussion draft](#) and [amendments](#)) by a vote of 41 to 28. Among other things, the bill would:

- Impose a fiduciary duty on brokers, dealers, and investment advisers “to act in the best interest of the customer without regard to [compensation]” and such standard of conduct “shall be no less stringent than” the standard for advisers under the Investment Advisers Act;
- Authorize FINRA to oversee any investment adviser who has any legal or financial connection with a broker;
- Require the registration of municipal financial advisers and impose upon them “a fiduciary duty,” as defined by the Securities and Exchange Commission (“SEC”);
- Authorize the SEC to “restrict or prohibit” mandatory pre-dispute arbitration clauses;
- Exempt companies with less than \$75 million in capital from section 404(b) of Sarbanes-Oxley;
- Establish a fund to pay monetary awards to whistleblowers;
- Make persons liable for aiding and abetting “to the same extent as the person to whom such assistance is provided”;

- Create a Financial Reporting Forum made of regulators and industry representatives to “meet and discuss . . . issues critical to financial reporting”; and
- Establish an Investor Advisory Committee to “advise and consult” with the SEC.

Credit Rating Agencies

On October 28, the HFSC reported favorably the “Accountability and Transparency in Rating Agencies Act” (H.R. 3890; see [discussion draft](#) and [amendments](#)) by a vote of 49 to 14. As passed by the Committee, the bill:

- Allows investors to sue agencies that “knowingly or recklessly” fail to review key information in their ratings;
- Provides the SEC with the authority to sanction supervisors at credit rating agencies for failing to supervise employees;
- Requires each agency to have a board with at least one-third independent directors and these directors shall oversee policies and procedures aimed at preventing conflicts of interest and improving internal controls;
- Contains requirements designed to mitigate the conflicts of interest that arise out of the issuer-pays model for compensating rating agencies;
- Includes disclosure provisions, including on payment; and
- Requires that if certain rating agency employees go to work for an issuer, the agency conduct a one-year look-back into the ratings in which the employee was involved to make sure that its procedures were followed and proper ratings were issued.

Private Funds

On October 27, the HFSC reported favorably the “Private Fund Investment Advisers Registration Act” (“PFIARA”; H.R. 3818; see [discussion draft](#) and [amendments](#)) by a vote of 67 to 1. Key provisions of PFIARA include:

- A requirement that advisers to most onshore and offshore private funds register with the SEC;
- A blanket carve-out for advisers to certain foreign private funds and small business investment companies;
- An exemption from SEC registration for advisers to venture capital funds and private funds with less than \$150 million in assets, although both would still be subject to SEC recordkeeping and reporting requirements;
- A requirement that advisers maintain and file records with the SEC in order to determine whether a particular fund poses a systemic risk;
- Information sharing among the SEC, the Federal Reserve, and any other entity the SEC identifies as having systemic risk responsibility; and
- A one-year transition period for investment adviser registration.

Areas of ongoing controversy include (1) whether family offices or family trusts should have an exemption from registration; (2) what, if any, other groups should receive a carve-out from the legislation; and (3) how best to protect proprietary information that is shared among agencies.

Consumer Financial Protection Agency

On October 22, the HFSC reported favorably the “Consumer Financial Protection Act” (H.R. 3126; see [Manager’s Amendment](#) and [amendments](#)) by a vote of 39 to 29. The bill, as passed by the HFSC, would:

- Create a Consumer Financial Protection Agency (“CFPA”) with supervisory, examination, and enforcement authority over consumer financial products and services;
- Exempt non-financial businesses, and products and services currently under the jurisdiction of the SEC or the Commodities Futures Trading Commission (“CFTC”); in addition, banks with \$10 billion or less in assets and credit unions with \$1.5 billion or less in assets can continue to be examined by their primary regulator rather than by CFPA examiners;

- Provide broad authority to promulgate new regulations and interpret regulations under 12 existing consumer banking laws; and
- Allow for stringent enforcement by the CFPB, the Department of Justice, the prudential regulatory agencies, the state Attorneys General, other state authorities, and through private rights of action.

For additional information on the CFPB, please see the recent K&L Gates Alert [Analysis of Consumer Financial Protection Agency Legislation: Top Ten Issues](#).

Subsequently, the House Energy and Commerce Committee, which has jurisdiction over aspects of the bill, requested sequential referral of the bill. The Energy and Commerce Committee reported favorably its version of H.R. 3126 on October 29 by a vote of 33 to 19 (see [Committee Print](#) and [amendments](#)). Significantly, this version of the bill establishes a five-member commission to run the CFPB. Chairman Frank opposes such an approach; the HFSC version of the bill would instead have the agency operated by a single director.

Negotiations and additional modifications are expected before the bill reaches the House floor.

Over-the-Counter Derivatives

On October 15, the HFSC reported favorably the “Over-the-Counter Derivatives Markets Act” (H.R. 3795; see [discussion draft](#) and [amendments](#)) by a vote of 43 to 27. Key provisions of H.R. 3795, as passed by the HFSC, include:

- A requirement that standardized swap transactions where both counterparties are either dealers or major swap participants be cleared;
- An exemption from clearing standardized swap transactions that involve end-users;
- A requirement that a standardized and cleared swap transaction where both counterparties are either dealers or major swap participants be executed on a Board of Trade, a National Securities Exchange or a swap execution facility;

- A requirement that swap dealers and major swap participants register with either the SEC or the CFTC and with both agencies if applicable;
- Mandatory reporting and recordkeeping for all over-the-counter derivative transactions;
- A requirement that swap transactions that are not cleared and for which no trade repository exists be reported to the relevant agency; and
- Mandatory registration with the SEC or CFTC as a swap execution facility for facilities that trade swaps that are not Boards of Trade or National Securities Exchanges.

On October 21, the House Agriculture Committee, which has joint jurisdiction, favorably reported its version of H.R. 3795 by voice vote (see [Committee Print](#) and [amendments](#)). Although the two Committee versions are similar in many respects, there are differences. The Rules Committee will likely issue a rule reconciling the areas in which the two bills diverge.

On November 3, HFSC Chairman Frank wrote a letter to SEC Chairman Mary L. Schapiro and CFTC Chairman Gary Gensler asking for help in bolstering the legislation. One bill provision that may be modified deals with who decides whether a trade can be cleared. As written, the legislation allows the clearinghouse to decide; however, a potential conflict of interest exists because financial firms have a stake in some clearinghouses and may not push for a swap to be cleared. As a result, Chairman Frank will seek to allow the relevant agency to determine whether a swap transaction should be cleared.

Senate

Over the past several months, Senate Banking Committee Chairman Dodd and Ranking Member Shelby have been quietly negotiating a Senate regulatory reform package. As noted previously, Chairman Dodd released a discussion draft, which takes the form of a single, large bill, on November 10.

The Senate legislation differs from the House version in a number of significant aspects. Most

notably, the Senate legislation calls for the consolidation of all existing banking regulators – the Federal Reserve, the FDIC, the OTS, and the OCC. An additional area of controversy is the CFPA. Although Chairman Dodd has said that the CFPA is an essential element of regulatory reform, Ranking Member Shelby and other panel Republicans are opposed to the idea, and instead support increased consumer protection efforts within existing regulatory bodies. Finally, Chairman Dodd is less enthusiastic about giving new systemic risk responsibilities to the Federal Reserve and is inclined toward giving more responsibility in that area to the FSOC.

Chairman Dodd has indicated that the Senate Banking Committee could begin marking up the legislation as early as the end of November and will work into December. However, in light of competing priorities, Senate floor action may still not occur until early next year.

Please see previous K&L Gates alerts, including [*Congress Builds on Obama Financial Regulatory Reform Approach, as Reform Efforts Proceed*](#) and [*House and Senate Take Expedited But Divergent Approaches to Financial Regulatory Reform Plan*](#) 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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