



BANKING LEGISLATION & POLICY

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HIGHLIGHTS

This issue contains detailed descriptions of:

- [The Proposed Implementation of the Volcker Rule](#), including:
 - [Definition of Banking Entities](#)
 - [Prohibition on Proprietary Trading](#)
 - [Prohibited Relationships with Hedge Funds and Private Equity Funds](#)
 - [Compliance Program](#)
- [Final Rules on the Resolution of Financial Institutions](#), including:
 - [Orderly Liquidation Authority](#)
 - [Resolution Plans](#)
- [New Swaps Market Regulation](#)

In addition, it summarizes [other notable legislative, regulatory, and judicial developments that occurred during the third quarter of 2011](#).

Proposed Implementation of the Volcker Rule

On October 11, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Securities and Exchange Commission (SEC) issued a [joint proposal](#) that implements section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, popularly known as the “Volcker rule.”^{1,2} The Volcker rule broadly prohibits insured depository institutions, bank holding companies,

and their affiliates (known collectively as banking entities) from engaging in short-term proprietary trading, and it forbids these banking entities from owning, sponsoring, or having certain relationships with hedge funds or private equity funds. These two components of the rule are each subject to a number of exceptions and qualifications, as discussed below.

Proprietary trading broadly refers to when a firm trades financial instruments (e.g., stocks or derivatives) for profit using its own money as opposed to clients’ money. Given the revenues proprietary trading generates for banking entities and the potential costs of compliance with the new

¹ For more information on the Dodd-Frank Wall Street Reform and Consumer Protection Act, see [Banking Legislation and Policy, Volume 29, Number 2](#).

² The Commodity Futures Trading Commission is expected to issue a similar proposal in the near future.

regulation, the Volcker rule and its implementation have generated some controversy. In 13 quarters from 2006 to 2010, stand-alone proprietary trading at the six largest U.S. bank holding companies produced \$15.6 billion in revenues, according to a Government Accountability Office report.³ However, Paul Volcker and many others contend that losses associated with these speculative activities played a key role in the recent financial crisis.

In designing the proposal, agencies looked to strike a balance between implementing the requirements of the new law while promoting sensible risk management and the continued supply of client-oriented financial services by banking entities. The proposal recognizes that there are often subtle distinctions between prohibited and permitted activities. These distinctions can be difficult to describe in regulation, leading to some uncertainty about the potential impact of any final rule.

In addition to the outlined prohibitions and exemptions, the proposed rulemaking would require banking entities to create an internal program that ensures and monitors compliance with the Volcker rule's restrictions. The Volcker rule also subjects nonbank financial companies supervised by the Federal Reserve Board to additional requirements (e.g., capital requirements or quantitative limits) if they engage in these activities, but the current proposal does not address this provision, in part because nonbank financial companies subject to this type of supervision had not yet been identified.

Banking Entities

Both of the primary components of the Volcker rule impose restrictions on the activities of so-called

³ Stand-alone proprietary trading refers to proprietary trading that occurs on stand-alone desks. This accounts for only a fraction of the proprietary trading in which banking entities engage.

“banking entities,” making the scope of this term important. The term “banking entity” includes any insured depository institution (e.g., a bank) except for certain limited-purpose trust institutions.⁴ It also includes any company that controls an insured depository institution (e.g., a bank holding company), certain foreign companies that are treated as bank holding companies under U.S. law, and affiliates or subsidiaries of any of the above banking entities. Certain affiliates and subsidiaries of a banking entity that operate as asset management units would not be considered banking entities.

Prohibition on Proprietary Trading

Proprietary trading by banking entities is prohibited under the agencies' new proposal. Broadly, a firm engages in proprietary trading when it trades financial instruments with its own money (as opposed to its customers' money) in an attempt to make a profit. The proposed rule further outlines the scope of the term “proprietary trading” and outlines a number of exceptions to the prohibition. The proposal also identifies factors that will be used to differentiate between permitted market-making activities and prohibited proprietary trading.⁵

Definition of Proprietary Trading

Under the proposal, proprietary trading refers to certain financial positions that are acquired on a banking entity's own trading account. In general, a proprietary trading account takes positions for short-term resale, to benefit from actual or expected short-term price fluctuations, to profit from short-term arbitrage, or to hedge one of these positions. The definition includes principal positions in

⁴ For example, an insured depository institution with nearly all of its deposits in trust funds might not be a banking entity under the proposal.

⁵ The agencies recognize that this differentiation “involves subtle distinctions that are difficult both to describe comprehensively within regulation and to evaluate in practice.”

securities, derivatives, commodity futures, and options and excludes positions in loans, spot foreign exchange, and spot commodities.⁶ Accounts with positions related to repo or reverse repo agreements, securities lending transactions, liquidity management functions, or clearing functions for derivatives or securities are not considered proprietary trading accounts. Certain financial positions taken by registered securities, swap, and security-based swap dealers related to their dealer activities are also considered proprietary trading under the proposal. Some trading activities identified in the agencies' new [market risk capital rules](#) are also classified as proprietary trading.⁷

Exceptions to Proprietary Trading Prohibition

Proprietary trading activities related to market making, underwriting, and risk-mitigating hedging are exempt from the prohibition. In addition, trading in government obligations, including debt issued by government-sponsored enterprises and municipal bonds, is exempt. Other exemptions include trading on behalf of customers, certain trading by insurance companies, and trading outside the U.S. by foreign entities. However, even trading activities that would otherwise be exempt are prohibited if they present a conflict of interest between the banking entity and its customers or counterparties, if they create a significant exposure to high-risk assets or trading strategies, or if they threaten the stability of the banking entity or the U.S. financial system.

Prohibited Relationships with Hedge Funds and Private Equity Funds

The second major component of the new proposal restricts the activities that banking entities can

engage in with hedge funds and private equity funds (known as covered funds). The rule generally would prohibit a banking entity from having an ownership interest in or acting as a sponsor of a covered fund. The proposal would also prohibit certain transactions between a banking entity and a covered fund, depending on their relationship.

Ownership Interest and Sponsoring

According to the proposal, an ownership interest would include any equity, partnership, or similar interest in a covered fund (e.g., stock shares or a general partnership interest) as well as equity-like debt (e.g., debt securities that give voting rights or the right to share in a covered fund's profits). Derivatives of such interests are also considered ownership interests. Ownership interests under the proposal are prohibited only if the banking entity is acting as principal. The term "sponsor" includes a general partner, managing member, commodity pool operator, and certain trustees. A banking entity also sponsors a covered fund if it shares the same name (or a variation of the same name) with the fund or if it selects or controls the majority of the fund's management, trustees, or directors.

Exceptions to Ownership Interest and Sponsoring Prohibitions

There are a number of exceptions to the ban on ownership interests in and sponsorship of a covered fund. Certain interests (known as carried interests) that would otherwise be considered ownership interests are excluded if the banking entity is an investment manager, investment adviser, or commodity trading adviser for the covered fund and if the interests are solely performance compensation. Activities geared toward risk-mitigating hedging and foreign activity by a foreign banking entity are also both allowed.

The proposed rule also exempts investments and activities with certain covered funds that promote the safety and soundness of banking entities and

⁶ Acting as an agent, broker, or custodian for a third party does not constitute proprietary trading.

⁷ For more information on the market risk capital rules, see [Banking Legislation and Policy, Volume 29, Number 4, pp. 17–18.](#)

the U.S. financial system. These funds include some common corporate organizational vehicles (e.g., a joint venture or an acquisition vehicle), certain issuers of asset-backed securities, and separate accounts used solely to purchase bank-owned life insurance (so-called BOLI accounts).⁸

There are additional exemptions related to covered funds organized and offered by a banking entity as a part of the entity's asset management businesses. Banking entities can also have ownership interest in or sponsor small business investment companies, public welfare investments, and qualified rehabilitation expenditures.

This listing of possible exemptions is not exhaustive. Similar to the proprietary trading prohibitions, these exceptions are all superseded if the banking entity's activity presents a conflict of interest, a significant exposure to high-risk assets or strategies, or a threat to the stability of the banking entity or the U.S. financial system.

Additional Restrictions

The proposal would also prohibit a banking entity from engaging in certain transactions with a covered fund if the banking entity serves (directly or indirectly) as the fund's investment adviser, investment manager, commodity trading advisor, or sponsor. The prohibited transactions include extensions of credit (e.g., loans), purchases of certain securities issued by the covered fund, acceptance of certain collateral securities, guarantees on behalf of the covered fund, and purchases of certain covered fund assets related to a repurchase agreement. These transaction restrictions also apply if the banking entity organized and offered the covered fund as a part of its asset management businesses.

⁸ Banking entities often take out life insurance policies on some of their key employees.

Compliance Program

The agencies' proposal requires banking entities to develop an internal program that monitors and ensures compliance with the Volcker rule. Banking entities fall into one of two broad groups with respect to the compliance program: Either they engage in exempted trading and fund activities (e.g., they conduct proprietary trading that falls under the market-making exemption) or they do not engage in any of these activities. For banking entities that engage in exempted trading and fund activities, each compliance program must include procedures to document and monitor trading and fund activities (including investments); internal controls that identify potential areas of noncompliance; a management framework that assigns responsibility for compliance; independent testing of the program; training for appropriate personnel (e.g., traders and managers); and recordkeeping that demonstrates compliance. Compliance programs for banking entities with significant trading and fund activities related to the rule must meet stricter criteria. For banking entities that do not engage in any proprietary trading or covered fund activities, compliance programs should include preventative measures to avoid such activities.

Reporting and Recordkeeping of Quantitative Measurements

Large banking entities with at least \$1 billion in trading assets and liabilities must report to regulators and document various quantitative measurements as well. These measurements are intended to identify high-risk assets and trading profiles as well as prohibited proprietary trading that might be misconstrued as exempt.

Treatment of Smaller, Less Complex Banking Entities

In crafting the proposal, regulators focused on limiting the burden for smaller banking entities. Hence, there are a number of requirements (e.g., recordkeeping and compliance program

requirements) that are more lenient for these entities. In general (and particularly when it comes to the compliance program), the proposed regulation takes a tiered approach in dealing with banking entities.

Resolution of Financial Institutions

One of the primary aims of the Dodd-Frank Act is to provide a legal framework for unwinding large financial institutions in a manner that preserves the financial stability of the United States (i.e., ending “too big to fail”). With that goal in mind, the FDIC, in coordination with the Federal Reserve Board, has adopted regulations that describe the FDIC’s authority to resolve nonviable financial institutions and outline the resolution plans that certain financial institutions must submit to regulators.

Orderly Liquidation Authority

Title II of the Dodd-Frank Act grants the FDIC the authority to take receivership of and resolve nonviable systemically important financial institutions. On July 6, the FDIC approved a [final rule](#) that establishes a comprehensive framework for the FDIC’s resolution authority following appointment as receiver. The rule aims to bring increased transparency to the orderly liquidation process and, among other things, outlines how creditors would be treated when the FDIC unwinds a failed nonbank financial institution, including the priority of payments and the process for determining claims. The rule represents the culmination of a series of rulemakings, including an October 2010 [proposed rule](#), a January 2011 [interim final rule](#), and a March 2011 [proposed rule](#).

Executive Compensation Recoupment

The final rule allows the FDIC to recover compensation from current or former senior executives and directors of a failed financial company if they are deemed substantially

responsible for the company’s failure.⁹ This recoupment provision generally applies to any compensation obtained during the two years preceding the FDIC’s receivership. In the case of fraud, the provision applies to compensation received at any time while an individual was an executive or director.

Priority of Payments for Unsecured Claims

The final rule lists 11 priority classes (e.g., administrative expenses of the receiver, general creditor claims, and post-insolvency interest) that govern the payment of unsecured claims. Each class will be paid in full before the next class receives anything, and funds will be allocated to a class pro rata if they are insufficient to cover all the class’s claims. The general goal of this process is to treat similarly situated creditors in a comparable manner. In particular, creditors who have lost setoff rights because of the FDIC’s sale or transfer of a failed company’s assets are granted priority over general unsecured creditors (but below administrative expenses, amounts owed to the U.S., and certain employee-related claims).¹⁰ Prior subordination contracts will also be respected. The rule addresses the scope of “administrative expenses” and “amounts owed to the U.S.,” which are two of the priority classes.

Process for Determining Claims

The Dodd-Frank Act gives the FDIC, as receiver of a failed financial company, the authority to determine all claims against the failed institution. The administrative claims process included in the final rule describes procedures for filing claims, claims determinations, and pursuing claims disallowed by the FDIC in court. The claims process does not apply to any bridge financial

⁹ See [76, Federal Register, pp. 41629](#) for a description of how the rule defines “substantially responsible.”

¹⁰ For example, an individual who is both a depositor at the institution under receivership and has an outstanding loan with the same institution might lose setoff rights if the FDIC sells the loan.

company (i.e., a financial company organized by the FDIC to resolve a nonviable firm). The FDIC's authority to determine claims also does not apply to extensions of credit from Federal Reserve Banks or from the FDIC itself.

Contingent and Secured Claims

Under the final rule, contingent claims will be recognized by the receiver at an estimated value. A contingent claim is a claim that may be owed by a debtor if certain events occur or certain conditions exist.¹¹ For secured claims, the assets securing the claim will be valued, and the value of the claim less the value of the collateral will be treated as an unsecured claim. Creditors with secured claims may seek possession of their collateral, which will be granted unless the FDIC elects to use, sell, or lease the collateral. If such control is not granted, the FDIC must provide adequate protection for the creditor's security interest.

Postponement of Criteria for "Financial Company"

Although the March 2011 proposal included criteria for determining if an institution is predominantly engaged in financial activities, such criteria were not included in the final rule and will be finalized in a future rulemaking. The FDIC is coordinating with the Federal Reserve to ensure that the two agencies define "financial companies" in an analogous fashion.

Other Components

The final rule addresses the FDIC's authority as receiver to avoid fraudulent and preferential transfers and synchronizes this authority with the relevant provisions of the bankruptcy code. It also ensures that employees of a company under FDIC receivership will still be paid for services rendered, in accordance with their personal service agreement, after the FDIC's receivership

appointment. Finally, the rule delineates certain ways in which the treatment of insurance companies and their subsidiaries may differ from that of other institutions in the resolution process. For example, the FDIC cannot take liens on the assets of an insurance company under receivership except under specific circumstances.

Resolution Plans

Large Bank Holding Companies and Nonbank Financial Companies

The FDIC and the Federal Reserve Board both approved a [final rule](#) that requires bank holding companies with at least \$50 billion in assets and certain nonbank financial institutions to submit annual plans on how they would be resolved in the face of significant financial distress or failure. Each plan should demonstrate a company's capacity for a rapid and orderly resolution under the U.S. Bankruptcy Code. Among other things, each company must describe the range of resolution actions it might take, the company's organizational structure, significant entities, corporate governance structure, interconnections with other institutions, management information systems, and supervisory and regulatory information. The Financial Stability Oversight Council (FSOC) will determine which nonbank financial institutions are subject to the resolution plan requirement in a separate rulemaking.

Companies with at least \$250 billion in nonbank assets must submit their initial plans by July 1, 2012. Remaining companies with at least \$100 billion in nonbank assets must submit their plans by July 1, 2013, and all other companies subject to the resolution plan requirement have until December 31, 2013. Companies falling under certain nonbank asset thresholds will have the opportunity to submit a more tailored resolution plan. Plans will be reviewed by the Federal Reserve Board, the FDIC, and the FSOC. More than simply providing additional information, the plans will be

¹¹ As an example, a creditor has a contingent claim on the cosigner of a loan. The claim is owed only if the principal debtor fails to pay.

expected to contain a strategic analysis of how a company can be resolved without posing systemic risk.

Large Insured Depository Institutions

The FDIC also adopted a complementary [interim final rule](#) that requires insured depository institutions with at least \$50 billion in total assets to submit resolution plans periodically. Since the FDIC has resolution authority over insured banks and thrifts, these plans must describe a viable path to rapid and orderly resolution under the FDIC's resolution authority, as opposed to under the U.S. Bankruptcy Code. The plans ideally will help the FDIC to reduce losses to the deposit insurance fund and to swiftly return insured funds to depositors if an insured bank or thrift fails. Thirty-seven institutions, which accounted for almost 60 percent of insured deposits as of 2010, are currently covered by the interim final rule.

New Swaps Market Regulation

The Commodities Futures Trading Commission (CFTC) continues to develop new regulations related to the swaps markets, as required by the Dodd-Frank Act.¹² Since the CFTC is defining a range of new types of participants and instruments, the following abbreviations are useful for understanding the regulation. Generally, an SD (swap dealer) is a market maker for swaps, such as a bank or investment bank; an MSP (major swap participant) is an entity with a substantial net position in swaps; a CPO (commodity pool operator) is an individual or organization, such as a hedge fund manager, that invests collective funds in commodity futures or options; an FCM (futures commission merchant) is an entity, such as an investment bank, that handles orders for futures contracts and extends credit to customers in the

futures market; a DCM (designated contract market) is an exchange, such as CME Group, on which futures or options are traded; an SEF (swap execution facility) is a platform for trading and clearing swaps such as a DCM; an SDR (swap data repository) is a centralized recordkeeping facility for data on swap transactions; and a DCO (derivatives clearing organization) is an entity, such as a clearinghouse, that allows each party in a transaction to substitute the credit of the DCO for the credit of the party. The definitions of these terms are still taking shape; therefore, more time is needed for the classifications to be completely delineated.

Mandatory Clearing and Clearing Eligibility

On July 19, the CFTC finalized the process it will use to determine if a DCO is eligible to clear a swap and if a swap is subject to mandatory clearing ([76, Federal Register, pp. 44464-75](#)). The Dodd-Frank Act grants the CFTC the authority to determine mandatory clearing requirements for swaps in order to reduce risk. Subject to CFTC review, a DCO is presumed eligible to clear any swap that is within a group or class of swaps that it already clears. For all other cases, CFTC approval to clear the swap is based on the DCO's financial resources and its ability to manage any risks associated with clearing the swap. A DCO must also submit to the CFTC any swaps it plans to accept for clearing to determine if they are subject to mandatory clearing. In reaching a decision, the CFTC will consider quantitative and qualitative factors, including outstanding notional exposures, trading liquidity, adequate pricing data, effect on systemic risk, effect on competition, and DCO members' views on the submission. In general, the CFTC will have 90 days from submission to make a determination if mandatory clearing of a swap is necessary. The CFTC will also review swaps that were listed by a DCO for clearing prior to the enactment of the Dodd-Frank Act to determine if they are subject to mandatory clearing. The clearing requirement may

¹² For more information on swaps market regulation, see [Banking Legislation and Policy, Volume 29, Number 4](#); [Banking Legislation and Policy, Volume 30, Number 1](#); and [Banking Legislation and Policy, Volume 30, Number 2](#).

be suspended for up to 90 days for further review, and the public will have the opportunity to comment on all swaps submissions. The CFTC will also study swaps that have not been accepted for clearing by any DCOs, with the possibility of imposing margin or capital requirements on the parties involved.

In September, the CFTC proposed a compliance schedule for clearing and trade execution requirements that, among other things, delays compliance until a series of related rules are finalized ([76, Federal Register, pp. 58186-97](#)).

Certification and Approval of New Rules and Products

In an effort to ensure that new rules, rule amendments, and new products issued by registered entities comply with the Commodity Exchange Act as amended by the Dodd-Frank Act, the CFTC issued a [final rule](#) (commonly known as the Part 40 rule) on July 19 that outlines the certification and approval process for such rules and products. Registered entities include designated contract markets (DCMs), DCOs, swap execution facilities (SEFs), and swap data repositories (SDRs). Systemically important DCOs (SIDCOs) must complete a special submission procedure for certain risk-related rules they propose. Among other things, SIDCOs must provide additional advance notice to the CFTC for certain risk-related rule changes. The final rule also prohibits products that are contingent on illegal activities, such as terrorism, assassination, or gaming, as well as products that are contrary to public interest.

Removal of References to Credit Ratings

The Dodd-Frank Act requires federal agencies to remove references to credit ratings from any assessments of creditworthiness in their regulations and instructs them to develop uniform standards of creditworthiness. The CFTC is continuing to work with other regulatory agencies to develop a

standard of creditworthiness that does not rely on credit ratings. In the meantime, the CFTC issued a [final rule](#) on July 19 that removes references to credit ratings in two of its existing regulations. The ratings references were removed from the minimum qualifications a non-U.S. bank must meet before FCMs and DCOs can deposit customer money with them and from the disclosures commodity pool operators (CPOs) must provide to their customers regarding the characteristics of the pool's investments.¹³ The CFTC still allows CPO disclosures to reference credit ratings when describing an investment but encourages CPOs to provide an independent assessment of creditworthiness where appropriate.

Timing of Acceptance and Documentation for Swaps Clearing

On July 19, the CFTC proposed new documentation requirements and timing of acceptance requirements for trade clearing ([76, Federal Register, pp. 45730-38](#)). The rule is intended to facilitate customer access to clearing and minimize the time between submission and acceptance (or rejection) of a trade for clearing. Under the proposal, FCMs, SDs, and MSPs would be prohibited from entering arrangements that would reveal a customer's original executing counterparty; limit a customer's number of counterparties; restrict a customer's position with specific counterparties apart from overall credit limits; hurt a customer's access to trade execution on terms reasonably close to the best terms available; or hinder clearing acceptance within specified time frames. The proposal would also require clearing members (FCMs, SDs, and MSPs) and DCOs to accept or reject trades for clearing in a time frame comparable to what would be

¹³ A commodity pool operator (CPO) is an organization or individual that operates a commodity pool. A commodity pool invests the collective funds of multiple participants in commodity futures or options. CPOs may also solicit funds for the commodity pool.

technologically realistic with a fully automated system (i.e., in a few minutes, at most). The rule does not require these institutions to implement fully automated systems for clearing acceptance.

Clearing Member Risk Management

On the same day, the CFTC proposed steps that clearing members must take to bolster their risk management ([76, Federal Register, pp. 45724-30](#)). The proposal would apply to FCMs, SDs, and MSPs that are clearing members. These entities would be required to develop credit and market risk-based limits based on factors such as position size, order size, and margin requirements. The proposal includes certain monitoring requirements that clearing members would follow to ensure that the risk-based limits are met and requires the use of automated means to screen orders for compliance. Clearing members would also conduct stress tests on all positions in proprietary accounts and all positions in customer accounts that could pose a material risk as well as assess their ability to meet margin requirements. A clearing member would estimate liquidation costs on a monthly basis and test all lines of credit on a quarterly basis.

Whistleblower Program

On August 4, the CFTC [adopted rules](#) to create a whistleblower program to reward individuals who

voluntarily provide original information to the CFTC that leads to successful enforcement actions. The program also prohibits a whistleblower's employer from retaliating against a whistleblower through the terms and conditions of employment.

Swap Data Repositories

On the same day, the CFTC implemented section 728 of the Dodd-Frank Act, which establishes SDRs as new registered entities ([76, Federal Register, pp. 54538-97](#)). SDRs will collect and maintain data on swap transactions in order to make the data readily available for regulators. All swaps, cleared and uncleared, must be reported to registered SDRs. The rulemaking establishes registration requirements, statutory duties, core principles, and certain compliance obligations for SDRs.

Compliance with Trading Documentation and Margining Requirements

On September 8, the CFTC proposed compliance schedules for previously proposed requirements related to documentation of swap trading relationships and margin obligations on uncleared swaps, among other things ([76, Federal Register, pp. 58176-86](#)). The proposal postpones the compliance until certain related rules, such as further definitions of "swap," "swap dealer," and "major swap participant," are finalized.

Federal Legislation

Proposed Legislation Related to the Dodd-Frank Act

A number of pieces of legislation were proposed that would amend or relate to the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Swap Execution Facility Clarification Act, introduced on July 19 by Representative Scott Garrett (R-N.J.), would limit the rules that can be imposed on swap execution facilities (SEFs), which were created by the Dodd-Frank Act ([H.R.2586](#)).

The Business Risk Mitigation and Price Stabilization Act, introduced on July 28 by Representative Michael Grimm (R-N.Y.), would clarify that margin requirements under the Dodd-Frank Act do not apply to end-users of derivatives ([H.R.2682](#)). End-users are nonfinancial companies that use swaps as a hedge against inherent business risk.

On September 22, Senator Richard Shelby (R-Ala.) introduced the Financial Regulatory Responsibility Act, which would require federal regulators to use enhanced economic analysis to justify any new financial rulemaking ([S.1615](#)). Specifically, regulators would be required to determine the effect of a proposed regulation on growth and net job creation. Any proposal with greater costs than benefits would be barred from consideration.

[H.R.3044](#), introduced on September 23 by Representative Francisco Canseco (R-Tex.), would repeal the creation of the Office of Financial Research (OFR). The OFR was created by the Dodd-Frank Act in order to collect and enhance the quality of financial data available to policymakers as well as to facilitate better analysis of the financial system. Some representatives have expressed concerns that the OFR might present possible cyber security risks because it would maintain such an extensive database of financial information in one central location.

The Retirement Income Protection Act, also introduced on September 23 by Representative Francisco Canseco (R-Tex.), would ensure that pension plans can continue to use swaps to hedge risks ([H.R.3045](#)).

Other Proposed Legislation

On July 15, Representatives Bill Posey (R-Fla.), Gregory Meeks (D-N.Y.), and Mario Diaz-Balart (R-Fla.) introduced [H.R.2568](#), which would prevent the IRS from requiring U.S. banks to report interest on deposits of nonresident aliens. Regulators would use the information to combat offshore tax evasion, but some legislators believe the enhanced reporting requirements would give foreign investors an incentive to withdraw their money from U.S. banks. The bill was referred to the House Committee on Ways and Means, and an identical bill was introduced in the Senate on August 2 ([S.1506](#)).

The Data Security Act of 2011, introduced on July 28 by Senator Thomas Carper (D-Del.), would require businesses and federal agencies to implement certain data security measures in order to protect personal consumer information ([S.1434](#)). It would also require that consumers be notified in the event of a personal data breach. This is the fourth time Carper has introduced the proposal. The bill was referred to the Senate Committee on Banking, Housing, and Urban Affairs.

The Homeownership Affordability Act, introduced on August 2 by Senators Robert Menendez (D-N.J.) and Johnny Isakson (R-Ga.), would extend higher maximum mortgage sizes eligible for purchase by Fannie Mae, Freddie Mac, and the Federal Housing Administration until 2013 ([S.1508](#)). The higher conforming loan limits subsequently expired on September 30, 2011, as the maximum eligible mortgage size decreased from \$729,750 to \$625,550 for a single-family residence in a high-cost area. The bill was referred to the Senate Committee on Banking, Housing, and Urban Affairs.

Federal Regulation

Multiple Sponsors

Transfer of OTS Powers

Title III of the Dodd-Frank Act abolishes the Office of Thrift Supervision (OTS) and transfers its responsibilities to the OCC, the FDIC, and the Federal Reserve. The transfer date was July 21, 2011. To accomplish this, these agencies have issued a series of rules to integrate former OTS responsibilities into their regulatory frameworks.

The OCC issued an [interim final rule](#) that lists the former OTS regulations it now enforces as well as a [final rule](#) that amends internal operations to reflect the transfer of certain functions. The OCC is now the primary regulator for federal savings and loan associations (thrifts). The FDIC and the Federal Reserve issued interim final rules similar to the one issued by the OCC regarding their new regulatory authority over state thrifts and thrift holding companies, respectively ([76, Federal Register, pp. 47652-47833](#) and [76, Federal Register, pp. 56508-56606](#)).

Board of Governors of the Federal Reserve System

Proposed Rule on Retail Foreign Exchange Transactions

On July 28, the Board of Governors of the Federal Reserve System (the Board) issued a [proposal](#) to protect retail customers who engage in certain foreign exchange transactions. The proposed rule would set standards for disclosure, recordkeeping, business conduct, and documentation when banks engage in retail transactions. The rule would apply to off-exchange futures and options on futures, over-the-counter options on foreign currency, and rolling spot transactions, but it would not affect regular spot transactions, listed options on foreign currency, and foreign currency forwards and swaps.¹⁴ Institutions would have to self-identify as engaging in such transactions, collect margin on the transactions, and be well capitalized. This proposed rule would apply to financial institutions regulated by the Federal Reserve, but the FDIC and the OCC have issued similar final rules for the institutions they oversee.

Proposal for Securities Holding Companies to Opt for Federal Reserve Supervision

In certain cases, securities holding companies (SHCs) might seek Federal Reserve supervision in order to satisfy a foreign regulator's requirements. On August 31, the Board proposed an [outline](#) for how SHCs could register for supervision by the Federal Reserve. An SHC is a nonbank company that owns a registered broker or dealer. Once registered with the Federal Reserve, an SHC would be regulated similar to a bank holding company.

Securities and Exchange Commission

Final Rule on Large Trader Reporting Requirements

On July 26, the SEC adopted a [final rule](#) establishing reporting requirements for large traders. The need for these reporting requirements is heightened by the increasingly prominent role of high-frequency traders – one type of large trader – in the securities markets. Large traders are identified as having transactions in exchange-listed securities that exceed 2 million shares or \$20 million during any calendar day, or 20 million shares or \$200 million during any calendar month. Large traders will have to register with the SEC, and the broker-dealers through whom they operate will have to maintain transaction records and report the information to the SEC on request.

Final Rule Removing Credit Ratings from Short Form Criteria

On July 26, the SEC issued a [final rule](#) that removes credit ratings as a factor in determining eligibility for “short form” registration. Eligible issuers use short forms to register securities offerings on an expedited basis

¹⁴ “Off-exchange” and “over-the-counter” in the context of derivatives both refer to derivatives that are not traded on an exchange (i.e., derivatives that are traded directly between two parties without a central counterparty). Rolling spot transactions generally require delivery of currency within two days (like a spot transaction) but in practice are sold on margin, repeatedly rolled over, and held for long periods, rarely ending in delivery. This gives them characteristics similar to those of futures contracts.

(known as “off-the-shelf” offerings). Previously, one requirement for short form eligibility was that the securities being offered have an investment grade rating from at least one nationally recognized statistical rating organization. The Dodd-Frank Act requires the SEC to remove the credit ratings criteria in order to reduce reliance on the rating agencies. The final rule replaces the credit ratings criteria by requiring issuers to satisfy one of four new tests for eligibility. The rule also includes a three-year grandfather provision in order to ease the transition.

Proposed Rules for Asset-Backed Securities

On July 26, the SEC [reproposed eligibility requirements](#) for issuers of asset-backed securities (ABS) that wish to use the shelf registration process. Shelf registration allows an issuer to register new ABS issues up to three years in advance, so they can offer the securities quickly when market conditions or other factors are favorable. The proposed requirements are designed to protect investors in ABS. Among other things, an eligible issuer must outline dispute resolution procedures and allow investors to communicate with one another. An executive officer of the issuer must also certify certain facts regarding the securitization. The proposal is a revised version of an April 2010 proposal and incorporates subsequent requirements of the Dodd-Frank Act as well as comments received.

On September 19, the SEC issued a [proposed rule](#) that aims to prohibit conflicts of interest between ABS packagers, sellers, and investors. The rule would prohibit securitizers of ABS from engaging in certain transactions in the year following the securitization that would present a conflict of interest. For example, under certain circumstances, the rule could prohibit a firm (e.g., an investment bank) from selling an ABS to an investor while shorting the ABS because the firm could profit at its investor’s expense.

Office of the Comptroller of the Currency

Final Rule with Preemption Provisions

On July 20, the OCC issued a [final rule](#) that, among other things, clarifies the scope of federal preemption in financial law. The rule eliminates preemption for subsidiaries of national banks and federal savings associations, applies to federal thrifts the same preemption standard that applies to national banks, and attempts to eliminate ambiguity in the preemption standards. These amendments to the OCC regulations implement revisions to the banking laws under the Dodd-Frank Act.

Rules on Retail Foreign Exchange Transactions

On July 28, the OCC adopted a [final rule](#) that gives the requirements national banks and their subsidiaries must meet in order to engage in certain off-exchange transactions in foreign currency with retail customers (retail forex transactions).¹⁵ The rule is similar to the Federal Reserve [proposal](#) discussed above. The OCC also adopted an [interim final rule](#) on September 12 that extends the retail forex requirements to federal savings associations.

¹⁵ In general, a retail forex transaction between a national bank and a retail customer is a future or option on a future; an option not traded or executed on a registered national exchange; or a transaction involving certain leverage or margin.