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Clients&FriendsMemo

Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act

August 12, 2010

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Act**") was signed into law by President Obama on July 21, 2010. The Act consists of sixteen distinct Titles on a wide variety of topics. Once implemented by the required regulations, the Act will significantly alter the U.S. financial regulatory system. All financial institutions will be directly and materially affected by the Act's accompanying regulations, and non-financial institutions that use regulated financial products will be indirectly affected. Additionally, the Act's amendments to Sarbanes-Oxley and broad changes to executive compensation and corporate governance rules will impact all U.S. public companies.

This Overview Memorandum is intended to provide a very brief summary of those Titles of the Act that are most significant to our clients. In addition to this Overview Memorandum, Cadwalader has prepared a series of memoranda, each discussing a different aspect of the Act and how it will affect different industries, types of entities and transactions. For a list of the related topic-specific memoranda, see Appendix A to this memorandum or visit our website.[1]

The Act was adopted in response to the economic crisis. Accordingly, the Act is intended to create future financial stability, better protect consumers and stimulate lending to underserved communities.

Nonetheless, we emphasize that the Act requires extensive regulations in order to be implemented. Accordingly, the ultimate impact of the Act is in large part still difficult to estimate. In the memoranda accompanying this overview, we have pointed out some of the questions we expect to arise. No doubt many open issues will be addressed in the adoption and implementation of regulations under the Act or in further amendments to the Act. That said, until regulations are proposed, it will be difficult for many of the financial institutions and companies that will be impacted by the Act to adopt more than tentative plans to adapt to its requirements.

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[1] The most recent Cadwalader, Wickersham & Taft Clients & Friends Memos are available here: http://www.cadwalader.com/list_client_friend.php.

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I. Title I: Financial Stability

Title I of the Act creates the Financial Stability Oversight Council ("**FSOC**"), which will identify systemically significant nonbank financial firms ("**SSNFs**") and regulate those institutions in a manner that will be, in certain circumstances, stricter than the current regulatory requirements generally applicable to banks and bank holding companies ("**BHCs**"). Title I also contains the "no de-banking" or "Hotel California" provision, which ensures that entities that are currently large BHCs remain subject to such heightened prudential requirements regardless of whether those institutions continue to be subject to the Bank Holding Company Act by reason of their ownership of an insured depository institution.

For more information on Title I, *see "Changes to the Regulation of Banks, Thrifts, and Holding Companies Under the Dodd-Frank Wall Street Reform and Consumer Protection Act"* and *"Regulation of Systemically Significant NonBanks Under the Dodd-Frank Wall Street Reform and Consumer Protection Act."*

II. Title II: Orderly Liquidation Authority

Title II of the Act creates a new "orderly liquidation authority" ("**OLA**") that allows the Federal Deposit Insurance Corporation ("**FDIC**") to seize control of a financial company whose imminent collapse is determined to threaten the entire U.S. financial system. This measure addresses companies considered "too big to fail." A determination by the designated government authorities that a failing company poses a systemic risk would authorize the FDIC to seize the entity and liquidate it under the new OLA, preempting any proceedings under the Bankruptcy Code. The only permitted outcome under the OLA is liquidation; rehabilitation, reorganization and debtor-in-possession proceedings are not an option for a financial institution subject to an OLA proceeding. Instead, the FDIC, in nearly all cases, will assume full control in an OLA seizure. Insurance companies, which remain subject to state regulation, are not covered by the OLA, but their holding companies and unregulated affiliates are subject to the OLA. Insured depository institutions will continue to be subject to the FDIA. In extending or maintaining credit, rating agencies, lenders and other potential creditors of a financial institution will now have to consider the effect of the OLA as well as the Bankruptcy Code on an institution that may become subject to Title II. While the OLA is modeled after the FDIC's existing framework for failed insured depository institutions, there are important differences that are discussed in our related memoranda.

For more information on Title II, *see "Orderly Liquidation of Financial Companies, Including Executive Compensation Clawback, Under the Dodd-Frank Wall Street Reform and Consumer Protection Act."*

III. Title III: Transfer of Powers to the Comptroller of the Currency, the Corporation, and the Board of Governors

Title III of the Act eliminates the Office of Thrift Supervision ("**OTS**") as the federal agency responsible for thrift and thrift holding company oversight (although the thrift charter itself is preserved), and distributes the OTS's existing responsibilities among the Federal Reserve, the FDIC and the Office of the Comptroller of the Currency. In addition, Title III alters the assessment methodology for funding the Deposit Insurance Fund, requiring that assessments be imposed on a depository institution's total liabilities (and not just its deposit liabilities). Title III also eliminates the 1.5% ceiling on the Fund's reserve ratio, and authorizes the FDIC to waive dividends when the Fund exceeds the target reserve ratio of 1.35%. Title III also permanently lifts the FDIC coverage limit to $250,000 and extends the FDIC's Transaction Account Guarantee ("**TAG**") program, which provides unlimited coverage for certain non-interest-bearing commercial transaction accounts, for an additional two years.

For more information on Title III, *see "Changes to the Regulation of Banks, Thrifts, and Holding Companies Under the Dodd-Frank Wall Street Reform and Consumer Protection Act."*

IV. Title IV: Regulation of Advisers to Hedge Funds and Other Institutions

Title IV of the Act, among other things, (i) alters the Securities and Exchange Commission ("**SEC**") registration criteria applicable to hedge fund managers and other investment advisers, materially changing the composition of the pool of registered investment advisers, (ii) significantly increases the record-keeping and reporting obligations applicable to registered and unregistered advisers to hedge funds and private equity funds, (iii) raises the "accredited investor" standard for individual investor eligibility to participate in private offerings (including offerings by hedge funds and private equity funds), and gives the SEC broad authority to adjust the "accredited investor" standard going forward, and (iv) applies inflation indexing to the "qualified client" standard under which registered advisers are permitted to charge performance-based compensation.

For more information on Title IV, *see "Hedge Fund Regulation Under the Dodd-Frank Wall Street Reform and Consumer Protection Act."*

V. Title V: Insurance

Title V of the Act creates the Federal Insurance Office within the Department of Treasury and grants it authority over all lines of insurance except for health insurance, certain long-term care insurance and crop insurance. The Federal Insurance Office is responsible for monitoring all aspects of the insurance industry within the United States, identifying issues

or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the U.S. financial system, making recommendations, coordinating federal efforts and developing federal policy on prudential aspects of international insurance matters as well as providing certain periodic reports to the President and Congress regarding insurance regulation and related matters. The Federal Insurance Office is also authorized to negotiate and enter into certain agreements relating to the business of insurance or reinsurance with foreign governments on behalf of the United States, preempting any state laws that are inconsistent with those agreements.

Title V is designed to promote uniformity in the insurance and the reinsurance market. Title V provides that the placement of non-admitted insurance (*i.e.*, casualty insurance placed with an insurer not licensed to engage in the business of insurance in the related state) is subject to the statutory and regulatory requirements solely of the insured's home state and prohibits, among other things, a state, other than the home state of the insured, to require any premium tax be paid for non-admitted insurance. Title V also promotes uniformity by prohibiting a state from collecting any fees relating to the licensing of a surplus lines broker[2] unless the state participates in the national insurance producer database of the National Association of Insurance Commissioners ("**NAIC**") or another equivalent uniform database.

Title V requires an insurer ceding (*i.e.*, purchasing) reinsurance to recognize credit if the state of domicile of the ceding insurer is an NAIC-accredited state (or has substantially similar financial solvency requirements in place) and preempts most laws or other actions of a state that is not the domiciliary state of the ceding insurer. Lastly, Title V delegates primary authority to regulate the financial solvency of a reinsurer to the state of domicile of the reinsurer.

For more information on Title V, *see "Insurance Reforms Under the Dodd-Frank Wall Street Reform and Consumer Protection Act."*

VI. Title VI: Improvements to Regulation of Bank and Savings Association Holding Companies and Depository Institutions

Title VI of the Act provides for heightened regulation, supervision, examination and enforcement powers over depository institution holding companies and their subsidiaries. Most significantly, Title VI expands the federal affiliate and insider transaction restrictions (Sections 23A, 23B, and 22 of the Federal Reserve Act) in particular with respect to

[2] The term "surplus lines broker" means an individual, firm, or corporation which is licensed in a state to sell, solicit, or negotiate insurance on properties, risks, or exposures located or to be performed in a state with nonadmitted insurers.

derivatives and sale-repurchase ("repo") transactions, imposes higher standards for BHCs to engage either in expanded "financial in nature" activities or in M&A activity, and expands the scope of existing national bank lending limits and requires state chartered banks to include derivatives within applicable state lending limits. Title VI also imposes a new nationwide growth cap (applicable both to BHCs and systemically significant nonbank companies), and places a partial moratorium on the creation of, or changes of control in, "nonbank banks." In addition, Title VI repeals "Regulation Q", thereby authorizing banks and thrifts to offer interest-bearing transaction accounts to commercial clients.

Title VI also contains the "Volcker Rule," which prohibits any "banking entity" from engaging in proprietary trading, or sponsoring or investing in a hedge fund or private equity fund. Although the Volcker Rule, as originally proposed, would have prohibited a banking entity from sponsoring or investing in a hedge fund or private equity fund, the Merkley-Levin amendment to the Volcker Rule (which was added in conference) creates a small number of limited exceptions to the prohibition, including exceptions for certain bona fide trust arrangements and "seed money" investments for funds organized by the banking entity, which may be retained subject to certain "de minimis" limits. While systemically significant nonbank financial companies are not prohibited from proprietary trading, or sponsoring or investing in a hedge fund or private equity fund, Title VI does subject these entities to additional capital requirements and quantitative limits on such activities.

For more information on Title VI, *see "Changes to the Regulation of Banks, Thrifts, and Holding Companies Under the Dodd-Frank Wall Street Reform and Consumer Protection Act."*

VII. Title VII: Wall Street Transparency and Accountability

Title VII (the "**Derivatives Legislation**") will give primary authority to the Commodity Futures Trading Commission (the "**CFTC**") and the SEC (the SEC, together with the CFTC, the "**Commissions**") to regulate the swaps market, both as to transactions and participants, although the various banking regulators (the "**Bank Regulators**") will retain substantial authority with respect to banks.

Among other things, the Derivatives Legislation will (i) require that certain "swaps" be traded on exchanges, centrally cleared and publicly reported, (ii) require the registration of both dealers in, and large end users of, swaps, with one or both of the Commissions, (iii) authorize the Commissions to establish a comprehensive regulatory system applicable to these registrants, (iv) require the establishment of new swap market mechanisms, including exchanges, clearing organizations and swap information repositories, and (v) give the Commissions broad and often overlapping powers that they would, in many instances

be required to use jointly, sometimes in conjunction with the Bank Regulators. The impact of the Derivatives Legislation reaches far beyond the swaps markets, having at least indirect application to spot or cash market trading.

Many of the key terms in the Derivatives Legislation are either undefined or are left for the regulators to fill in. Further, there are provisions of the legislation that may not be readily feasible to implement, such as the authority given the Commissions over the capital requirements of end-users. Other provisions may require substantial clarification or amendment, including the definition of the term "swap."

For more information on Title VII, *see "The New Scheme for the Regulation of Swaps, with Appendices on Retroactivity, Special Entities and Tax, Under the Dodd-Frank Wall Street Reform and Consumer Protection Act"* and *"Regulation of End Users of Swaps Under the Dodd-Frank Wall Street Reform and Consumer Protection Act."*

VIII. Title VIII: Payment, Clearing, and Settlement Supervision

Title VIII, the "**Payment, Clearing and Settlement Supervision Act of 2010**", provides for increased regulation of and emergency federal assistance to (i) financial market utilities ("**FMUs**") and (ii) financial institutions that engage in payment, clearing and settlement ("**PCS**") activities that are in each case deemed to be systemically significant.[3] Title VIII, which is effective immediately upon enactment, provides the FSOC the authority to designate any institution that is an FMU or any PCS activity as systemically important. Upon such a designation, the Federal Reserve is given authority to oversee the prudential regulation of designated FMUs and all financial institutions that engage in the designated PCS activities. Designated FMUs are provided access to the Federal Reserve's discount window in exigent circumstances and are subject to heightened notice requirements with respect to rule, policy and operational changes that could affect risk. The SEC and the CFTC are also required to consult with the Federal Reserve regarding certain derivatives clearing matters, including mandatory clearing determinations.

IX. Title IX: Investor Protections and Improvements to the Regulation of Securities

Title IX of the Act covers a wide range of subject matters including (i) changes to the regulatory requirements applicable to broker-dealers and investment advisers, (ii) new significant requirements relevant to credit rating agencies and structured finance products,

[3] FMUs are defined to include persons who operate multilateral systems for transferring, clearing or settling payments, securities or financial transactions among financial institutions.

and (iii) rules related to executive compensation and corporate governance that apply to public companies generally, not merely to those engaged in financial activities.

As to broker-dealers and investment advisers, Title IX is primarily significant for requiring the SEC to conduct studies and to impose rule requirements relating to the services that they provide to retail customers and to other customers that the SEC may designate. The Title also provides a good number of statutory amendments, including provisions relating to short sales and securities lending under Subtitles B and I, transaction reporting by large shareholders and Section 16 insiders under Subtitle B, amendments to Securities Investors Protection Act provisions relevant to broker-dealer insolvency under Subtitles B and I, additional regulation of the municipal securities markets under Subtitle H, and restructuring of the SEC under Subtitle F. For more information on Title IX and its impact on broker-dealers and investment advisers, see *"Changes to the Regulation of Broker-Dealers and Investment Advisers Under Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act."* For more information as to Title IX's application to investment advisers, see *"Hedge Fund Regulation Under the Dodd-Frank Wall Street Reform and Consumer Protection Act."*

Subtitle C of Title IX, entitled "Improvements to the Regulation of Credit Rating Agencies," institutes reforms in the regulation, oversight and accountability of nationally recognized statistical rating organizations ("**NRSROs**"). The Act expresses Congressional concerns with the conflicts of interest faced by credit rating agencies and with the inaccuracy of ratings on structured finance products, which "contributed significantly to the mismanagement of risks by financial institutions and investors," resulting in the need for "increased accountability on the part of credit rating agencies." The consistent theme of the provisions of Subtitle C of Title IX is to identify and eliminate conflicts of interest and restore confidence in the ratings process. Subtitle D of Title IX, entitled "Improvements to the Asset-Backed Securitization Process," institutes reforms to the asset-backed securitization process by requiring (i) risk retention ("skin in the game"), (ii) increased disclosure and (iii) ongoing periodic reporting. For more information on Subtitles C and D, *see "Reforms to the Asset-Backed Securitization Process and the Regulation of Credit Rating Agencies Under the Dodd-Frank Wall Street Reform and Consumer Protection Act."*

Subtitles E and G of Title IX include broad changes to executive compensation and corporate governance rules for publicly traded companies and financial institutions, including mandatory non-binding shareholder votes on executive compensation and golden parachutes, compensation committee independence requirements, certain executive compensation disclosures, and "clawbacks" of erroneously awarded compensation. These subtitles also require disclosure regarding employee and director hedging, financial

institutions' incentive-based compensation arrangements, and disclosures of the relationship between the chairman and CEO of a company. Finally, Title IX places limits on broker voting and increases proxy access for shareholders. For more information on these issues, *see "Executive Compensation and Corporate Governance Provisions Under the Dodd-Frank Wall Street Reform and Consumer Protection Act"* and *"Amendments to SOX, Including Section 404(b) Exemption for Nonaccelerated Filers, Under the Dodd-Frank Wall Street Reform and Consumer Protection Act."*

X. Title X: Bureau of Consumer Financial Protection

Title X of the Act establishes the Bureau of Consumer Financial Protection ("**BCFP**") as an independent bureau within the Federal Reserve. The BCFP will have authority to issue rules applicable to all financial institutions, including depository institutions, that offer financial products and services to consumers. The BCFP will have examination and enforcement authority with respect to consumer financial laws over very large banks and nonbank financial institutions. The BCFP will not have authority over insured depository institutions and credit unions with assets of $10 billion or less.

XI. Title XI: Federal Reserve System Provisions

Title XI of the Act limits the authority of the Federal Reserve to engage in emergency lending and requires certain audits of the Federal Reserve with respect to its emergency lending activities during the financial crisis. The Title also establishes the position of Vice Chairman for Supervision at the Federal Reserve.

XII. Title XII: Improving Access to Mainstream Financial Institutions

Title XII of the Act authorizes the Secretary of the Treasury to establish certain programs directed at improving access to basic financial products for underserved communities.

XIII. Title XIII: Pay It Back Act

Title XIII (the "**Pay It Back Act**") amends the Emergency Economic Stabilization Act of 2008, the American Recovery and Reinvestment Act of 2009 ("**ARRA**") and other related acts to limit the Troubled Asset Relief Program ("**TARP**") and earmark certain funds to be used for deficit reduction. Specifically, the Pay It Back Act, among other things, reduces the amount of TARP funds available to the Secretary of the Treasury by $225 billion, ends the Secretary of the Treasury's ability to fund new programs under TARP as of June 25, 2010 and requires certain funds received by the Secretary of the Treasury to be used to reduce the deficit, including funds received in connection with: (i) the sale of certain Fannie Mae, Freddie Mac and Federal Home Loan Bank obligations owned by the U.S.

Department of Treasury, (ii) the payment of certain fees by Fannie Mae or Freddie Mac to the U.S. Treasury under certain programs authorized under the Housing and Economic Recovery Act of 2008, (iii) the rejection by States of certain funds made available to states or local governments under ARRA and (iv) the failure to use certain discretionary appropriations made available under ARRA by December 31, 2012.

XIV. Title XIV: Mortgage Reform and the Anti-Predatory Lending Act

Title XIV of the Act, the "**Mortgage Reform and Anti-Predatory Lending Act**," provides for increased disclosure requirements with respect to origination of residential mortgage loans. The Act contains a significant increase in regulation of mortgage loan origination and servicing practices. In particular, it sets new criteria under the Truth in Lending Act for creditors to originate mortgage loans, and restricts certain lending activities with respect to certain high cost residential mortgage loans. These restrictions become effective six months following enactment of the statute. The remainder of the provisions become effective when regulations are promulgated pursuant to the Act.

XV. Title XV: Miscellaneous Provisions

Title XV contains a number of unrelated provisions, including (i) a requirement that the U.S. Executive Director at the International Monetary Fund (the "**IMF**") consider a country's public debt relative to its gross domestic product and to oppose extending IMF loans unlikely to be repaid in full, (ii) an amendment to the Securities Exchange Act of 1934 (the "**Exchange Act**") to add a disclosure requirement by companies using minerals originating in the Democratic Republic of Congo, (iii) a provision imposing safety reporting requirements by public issuers that operate coal mines, (iv) amendments to the Exchange Act requiring issuers involved in resource extraction to disclose payments made to a foreign or U.S. government for the purpose of development of oil, natural gas, or minerals, (v) a report by the Comptroller General assessing the relative independence, effectiveness, and expertise of presidentially appointed inspectors general, and (vi) a study to evaluate the impact of "core deposits" and "brokered deposits" at U.S. banking institutions.

XVI. Title XVI: Section 1256 Contracts

Title XVI amends Section 1256 of the Internal Revenue Code to provide that interest rate swaps, currency swaps, basis swaps, interest rate caps, interest rate floors, commodity swaps, equity swaps, equity index swaps, credit default swaps, and similar agreements are not treated as Section 1256 contracts. Had Section 1256 applied to these financial instruments, they would have been required to be marked-to-market annually for tax purposes, and any gain or loss would have been 60% long-term and 40% short-term capital gain or loss, potentially giving rise to inappropriate timing and character

mismatches. The amendments will apply to taxable years beginning after the date of the enactment of the Act.

For more information on Title XVI, *see* "*The New Scheme for the Regulation of Swaps, with Appendices on Retroactivity, Special Entities and Tax, Under the Dodd-Frank Wall Street Reform and Consumer Protection Act.*"

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We hope you find this helpful. Please feel free to contact the Cadwalader attorneys with whom you ordinarily work if you have any questions about the Act or this memorandum and you will be directed appropriately depending on the specific subject matter.

Appendix A

I. "Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act"

II. "Changes to the Regulation of Banks, Thrifts, and Holding Companies Under the Dodd-Frank Wall Street Reform and Consumer Protection Act"

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