

# ClientAlert

## Financial Markets Developments

June 2009

### President Obama Unveils Plan to Reshape Financial Regulation

**On June 17, 2009, the White House unveiled a comprehensive plan to revamp financial regulation and supervision (the "Plan").<sup>1</sup> The Plan introduces a series of significant proposals, including:**

- Empowering the Federal Reserve Board (the "**Federal Reserve**") with comprehensive authority to identify and to enforce stricter regulation of any firm whose failure could pose a threat to financial stability based on its size, leverage and interconnectedness (a "**Tier 1 FHC**");
- Creating a Financial Services Oversight Council (the "**Council**") to facilitate information sharing, coordinate among the agencies to identify risks and resolve jurisdictional disputes, and to advise the Federal Reserve on the identification of Tier 1 FHCs;
- Requiring all advisers to hedge funds, private equity funds, venture capital funds and other private pools of capital, whose assets under management exceed a modest threshold, to register with the Securities and Exchange Commission (the "**SEC**") under the Investment Advisers Act of 1940 (the "**Advisers Act**");
- Requiring that broker-dealers offering investment advice be subject to fiduciary duties similar to investment advisers and otherwise harmonizing the regulation of broker-dealers and investment advisers;
- Enacting regulations that would result in structural changes in the securitization markets that align compensation of market participants with the performance of underlying loans and that increase transparency;
- Providing substantial protections to consumers of financial products and services, which are broadly defined, under the umbrella of a new Consumer Financial Protection Agency (the "**CFPA**"); and
- Coordinating international financial policy and regulations with governments and organizations around the globe.



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<sup>1</sup> The entire Plan is [available here](#) (PDF).

Administration officials said that the Plan follows months of discussions with Congress, regulators, business and consumer groups, financial company executives, academics and other experts. The stated goal of the Plan is “to create a more stable regulatory regime that is flexible and effective; that is able to secure the benefits of financial innovation while guarding the system against its own excess.”<sup>2</sup>

The Plan has five main stated objectives:

- to promote robust supervision and regulation of financial firms;
- to establish comprehensive supervision and regulation of financial markets;
- to protect consumers and investors from financial abuse;
- to improve tools for managing financial crisis; and
- to raise international regulatory standards and improve international cooperation.

This client alert briefly summarizes the various proposals and recommendations included in the Plan. The Plan, a wide-ranging white paper, states that the Administration’s proposals and recommendations do not represent the complete set of potentially desirable reforms in financial regulation, but instead aim to address the causes of the current crisis, create a more stable and fair financial system, and the means to contain potential future crises. The reforms in the Plan target the specific challenges posed by the financial markets over the past year. In designing the Plan, the Administration focused on the need for a flexible system equipped to address new and innovative products and structures not yet contemplated or foreseeable today. Simply put, the aim of the Plan is to prevent a repeat of the catastrophes of the past year and to avoid being caught flat-footed again. The Plan requires continuous monitoring of the financial markets and a significant degree of coordination among various agencies within the federal government, and arming the Federal Reserve with significantly more authority. A major theme of the Plan is the need to restructure the regulatory regime to prevent regulatory forum shopping by certain kinds of financial firms, which was cited as a fundamental weakness of the current system.

We expect that the Plan will elicit strong opinions and a great deal of commentary from the same parties that had input on the Plan, as well as law firms, financial institutions, and other

industry constituents. It is important to note that the new laws and regulations necessary to implement these proposals have yet to be published and, to a large extent, may not even be drafted yet. Translating the Plan’s proposals into law will be a lengthy process in which lawmakers, industry participants, interest groups and other stakeholders may have competing interests. The prevailing “anti-Wall Street” public opinion and the expected resistance from the financial industry will also play significant roles in shaping changes to the status quo. Therefore, a significant degree of uncertainty remains regarding which of the Plan’s proposals will come to pass and the form in which they will be implemented.

Nevertheless, the mere propagation of this Plan may cause certain irreversible shifts in attitudes of credit rating agencies, regulators and investors. Indeed, rating agencies have already started assessing banks in terms of the probable impact of these proposals and the Plan’s compensation proposals reinforce the country’s populist mood. We will continue to follow developments relating to the Plan, from legislative and regulatory proposals to changes in market practice that may be appropriate in light of the Plan’s ambitious revisions to US banking and securities laws.

The Plan’s proposals for changes to the regulatory regime are organized on the basis of its main stated objectives. Many of the proposals are referred to in the context of different objectives, reflecting the Administration’s belief that many of the proposals will address multiple objectives and intention to further centralize the regulation of the financial industry.

### **Promote Robust Supervision and Regulation of Financial Firms**

The goal of the proposals included under the first objective is to create robust and consistent regulatory standards applicable to financial institutions of comparable size and scale. The proposals target what the Administration deems to be inadequate and inconsistent supervision and regulation of financial firms. Specifically, the “Plan” states that the proposals are necessary to address the following regulatory and supervisory weaknesses: (1) capital and liquidity requirements were too low, (2) regulators did not take into account the harm that the failure of large, interconnected and highly leveraged institutions could cause, (3) the responsibility for supervising the operations of large financial firms was fragmented across various federal agencies, and (4) investment banks, money market mutual funds, and hedge

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2 Timothy Geithner and Lawrence Summers, “A New Financial Foundation,” The Washington Post (June 15, 2009).

funds and other private pools of capital operated with insufficient government oversight. The following specific proposals seek to address these four vulnerabilities:

- **Create a Financial Services Oversight Council:** The Plan proposes the creation of the Council<sup>3</sup>, which would ultimately replace The President's Working Group on Financial Markets, to facilitate information sharing and coordination, identify emerging risks, and advise the Federal Reserve on the identification of Tier 1 FHCs, whose failure could pose a threat to financial stability. The Council would have the authority to gather information from any US financial firm and the responsibility for referring emerging risks to the attention of regulators with the authority to respond appropriately. As discussed throughout the sections below, the Plan proposes a number of specific additional roles for the Council, typically as a consultant to other regulatory agencies.
- **Implement Heightened Supervision and Regulation by the Federal Reserve Board of All Large Interconnected Financial Firms:** The Plan proposes to make the Federal Reserve responsible for the supervision and regulation of all Tier 1 FHCs. The reason for this change is the Administration's belief that many financial firms that contributed to the financial crisis owned federally insured depository institutions that were not considered banks under the Bank Holding Company Act, therefore eluding the oversight regime applicable to bank holding companies ("BHCs"). This proposal would subject all Tier 1 FHCs to increased supervision and regulation, regardless of whether they are currently supervised as BHCs. The criteria the Federal Reserve must consider in identifying a Tier 1 FHC would include, among other relevant factors, the impact that the firm's failure would have on the financial system and the economy, the firm's systemic importance under stressed conditions, the firm's combination of size, leverage and degree of reliance on short-term funding, and the firm's importance as a source of credit for households, businesses and state and local governments, and liquidity for the financial system. If a firm has one or more of its subsidiaries subject to regulation by other federal regulators, the Federal Reserve would be required to consult those regulators before requiring the firm to be regulated as a Tier 1 FHC. To enable the identification of Tier 1 FHCs, the Plan recommends that Congress authorize the Federal Reserve to collect periodic reports from and examine all US financial firms that meet certain minimum size thresholds to the extent reasonably necessary to determine whether the firm is a Tier 1 FHC.

Under the Plan, the Administration will seek to ensure that the supervisory authority and standards adopted by the Federal Reserve for Tier 1 FHCs would be stricter and more conservative than those applicable for other regulated financial firms. It is

proposed that the Federal Reserve, in consultation with the Council, set standards that, at a minimum, require Tier 1 FHCs to meet the qualification requirements for FHC status (as revised by the Plan and discussed below), including strict capital and liquidity requirements, a prompt corrective action regime should capital levels decline outside of acceptable parameters, the implementation of risk management practices, public disclosure requirements, restrictions on non-financial activities and rapid resolution plans in the event of severe financial distress. The Federal Reserve's supervision of Tier 1 FHCs must take into account risks to the individual institutions as well as the financial system as a whole, with particular attention paid to the potential impact of the interconnection, as to activities and risk exposure, of Tier 1 FHCs, critical markets and the broader financial system. The reforms are designed to prevent the public from bearing the costs of a failure of a Tier 1 FHC by requiring that Tier 1 FHCs be equipped to absorb such costs internally.

According to the Plan, the supervision and regulation of Tier 1 FHCs would extend to the parent company and all of its subsidiaries, regardless of whether they were regulated or unregulated, US or foreign. Regulated and depository institution subsidiaries of a Tier 1 FHC would continue to be regulated by their functional or bank regulator, as the case may be. The Plan proposes to eliminate the Gramm-Leach-Bliley Act-imposed limitations on the Federal Reserve's ability to require reports from, examine or impose higher prudential requirements or activity restrictions on functionally regulated or depository institution subsidiaries. The Federal Reserve would have the authority to impose and enforce stricter requirements than those currently required on a regulated subsidiary of a Tier 1 FHC to address systemic risk concerns, after consulting with such subsidiary's primary federal or state supervisor and the Treasury.

The Plan proposes that the Federal Reserve, in consultation with the Treasury and external experts, propose recommendations by October 1, 2009, to better align its structure and governance with its new authority and responsibilities.

- **Strengthen Capital and Other Prudential Standards Applicable to All Banks and BHCs:** The Plan includes a number of proposals to strengthen capital and other prudential standards of banks and BHCs, including:
  - **Reassessment of existing regulatory capital requirements for banks and BHCs:** The Plan notes that the capital rules in place in the early stages of the financial crisis did not require banking firms to hold enough capital in light of their risks.

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<sup>3</sup> The Financial Services Oversight Council would be comprised of (i) the Secretary of the US Department of the Treasury (the "Treasury"), as chairman, (ii) the Chairman of the Board of Governors of the Federal Reserve System, (iii) the Director of the National Bank Supervisor, (iv) the Director of the CFPB, (v) the Chairman of the SEC, (vi) the Chairman of the Commodity Futures Trading Commission (the "CFTC"), (vii) the Chairman of the Federal Deposit Insurance Corporation (the "FDIC"), and (viii) the Director of the Federal Housing Finance Agency.

Accordingly, the Treasury will lead a working group that will conduct a fundamental reassessment of existing regulatory capital requirements for banks and BHCs, including new Tier 1 FHCs. The working group will be directed to issue a report on its conclusions by December 31, 2009. The review would cover all elements of the regulatory capital framework, including composition of capital, scope of risk coverage, relative risk weights and calibration.

– **Reassessment of existing supervision of banks and BHCs:**

The Treasury will also lead a working group that will be directed to conduct a fundamental reassessment of the supervision of banks and BHCs. This working group will issue a report on its conclusions by October 1, 2009. Many of the large financial firms that failed or nearly failed were, in fact, subject to supervision and regulation by a federal government agency. Therefore, the Administration believes it is necessary for the working group to address a variety of supervisory issues, such as (i) how to conduct effectively continuous, on-site supervision of large, complex banking firms, (ii) what information supervisors must obtain from regulated firms on a regular basis, (iii) how functional and bank supervisors should interact with consolidated holding company supervisors, (iv) how federal and state supervisors should coordinate with foreign supervisors, (v) the extent to which the supervision of smaller firms should differ from the supervision of larger firms, (vi) the funding of supervisory agencies and (vi) the cost and benefits of having supervisory agencies conduct other government functions.

– **New standards and guidelines to align executive compensation with long-term shareholder value:**

The Plan provides that the Administration will seek to align compensation practices with the interests of shareholders, and the stability of firms and the financial system through five principles: (i) compensation plans should properly measure and reward performance, (ii) compensation should be structured to account for the time horizon of risks, (iii) compensation practices should be aligned with sound risk management, (iv) golden parachutes and supplemental retirement packages should be reexamined to determine whether they align the interests of executives and shareholders and (v) transparency and accountability should be promoted in the process of setting compensation. Among other specific measures, the Administration will work with Congress on “say on pay” legislation that will require all public companies to offer an annual non-binding vote on compensation packages for senior officers and propose legislation giving the SEC the power to require more independence of compensation committees.

– **All FHCs should be required to meet the capital and management requirements on a consolidated basis, as opposed to just the subsidiary depository institution level.**

– **Review of accounting standards:** The Plan proposes that the Financial Accounting Standards Board (“**FASB**”) and the International Accounting Standards Board (“**IASB**”) review accounting standards to determine how financial firms should be required to employ more forward-looking loan loss provisioning practices that incorporate a broader range of available credit information. Also, the Administration contends that fair value accounting measures should be reviewed with the goal of identifying changes that could provide users of financial reports with both fair value information and greater transparency regarding the cash flows.

– **Strengthening of firewalls between banks and their affiliates:** As noted in the Plan, Sections 23A and 23B of the Federal Reserve Act are designed to protect a depository institution from suffering losses in its transactions with affiliates. However, the Administration believes that this firewall framework should be strengthened to protect the federal safety net that supports banks, which includes FDIC deposit insurance, access to Federal Reserve liquidity and access to Federal Reserve payment systems, and to better prevent the spread of the subsidy of the federal safety net to bank affiliates.

■ **Close Loopholes in Bank Regulation; Create the National Bank Supervisor:** The Administration proposes to create a new federal government agency within the Treasury, the National Bank Supervisor (the “**NBS**”), to conduct prudential supervision and regulation of all federally chartered depository institutions and all federal branches and agencies of foreign banks. The NBS would take over the responsibilities of the Office of the Comptroller of the Currency and the Office of Thrift Supervision and inherit their respective authorities to require reports, conduct examinations and overall supervision and impose and enforce prudential requirements. The Plan also proposes to eliminate the federal thrift charter, but to preserve its interstate branching rules and apply them to state and national banks. Further, the Plan provides that all companies that control an insured depository institution should be subject to robust consolidated supervision and regulation by the Federal Reserve and should be subject to the nonbanking activity restrictions of the BHC Act. Under the Plan, loopholes in the BHC Act for thrift holding companies, industrial loan companies, credit card banks, trust companies and grandfathered “non bank” banks would be closed.

■ **Require Hedge Funds and Other Private Pools of Capital to Register:** Following the lead of the legislation that has already been introduced as described in detail below, the Plan proposes that all advisers to hedge funds, private equity funds, venture capital funds and other private pools of capital, whose assets under management exceed a modest threshold<sup>4</sup> should be required to register with the SEC under the Advisers Act. The Administration believes that hedge fund deleveraging contributed to the strain on the financial markets and that the government lacks reliable, comprehensive data to assess the activity of private funds. To combat this lack of information, the Plan requires the consistent collection of data from private fund advisers, on a confidential basis, with respect to their assets under management. While recognizing that the requirements may vary depending on the type of underlying pool of assets, the Plan requires that all investment funds advised by an SEC-registered investment adviser be subject to record-keeping requirements, requirements with respect to disclosures to investors, creditors and counterparties, and various regulatory reporting requirements. Further, the Plan maintains that the SEC should conduct regular, periodic examinations of private funds to monitor compliance with the disclosure and record-keeping requirements. The Plan proposes that the SEC would then share its reports on private funds with the Federal Reserve, which would then determine whether any of the funds or fund families should be supervised and regulated as Tier 1 FHCs.

The potential registration of private funds and advisers to private funds has been discussed at length recently, in Congress, state legislatures and among many industry participants and commentators. The “Hedge Fund Adviser Registration Act of 2009,” introduced in the US House of Representatives on January 27, 2009, would require most private investment advisers to register by eliminating the fifteen client de minimis exception in Section 203(b)(3) of the Advisers Act. On January 29, 2009, the “Hedge Fund Transparency Act” was introduced by Senators Chuck Grassley (R-Iowa) and Carl Levin (D-Michigan). This bill seeks to cause private funds with more than US\$50 million in assets to register as investment companies with the SEC under the Investment Company Act of 1940 (the “**Investment Company Act**”), provide significant annual public disclosures, maintain books and records in accordance with SEC rules and

cooperate with the SEC on any requests for information.<sup>5</sup> A third bill, the “Private Fund Transparency Act of 2009,” introduced on June 16, 2009 by Senator Jack Reed (D-RI), would require all hedge fund and other investment pool advisers that manage more than US\$30 million in assets to register as investment advisers with the SEC, impose certain disclosure requirements and clarify other aspects of the SEC’s authority in order to strengthen its ability to oversee registered investment advisers. States have also been active in this area. In Connecticut, the home of hundreds of private funds, some state legislators grew frustrated with the federal government’s inaction to date and introduced three bills in recent months targeting the regulation of private funds and their sponsors. None of these bills, however, progressed and the Connecticut legislature failed to pass any of the measures before the end of its most recent legislative session on June 3, 2009.

■ **Reduce the Susceptibility of Money Market Mutual Funds to Runs:** The Plan states that the SEC should move forward with its plan to strengthen the regulatory framework for money market mutual funds (“**MMFs**”) to reduce the credit and liquidity risk profile of individual MMFs and to make the MMF industry as a whole less susceptible to runs. As part of this process, the SEC should consider (i) requiring MMFs to maintain substantial liquidity buffers, (ii) reducing the maximum weighted average maturity of MMF assets, (iii) tightening the credit concentration limits applicable to MMFs, (iv) improving the credit risk analysis and management of MMFs, and (v) empowering MMF boards of directors to suspend redemptions in extraordinary circumstances to protect the interests of shareholders. Also, the Plan charges The President’s Working Group on Financial Markets with preparing a report by September 15, 2009, assessing whether additional fundamental changes are necessary to address systemic risk posed by MMFs and further reduce the MMF industry’s vulnerability to runs.

■ **Enhance Oversight of the Insurance Sector:** The Plan acknowledges the integral role of insurance in the functioning of the financial system and the economy. Accordingly, the Administration will propose legislation to establish the Office of National Insurance (the “**ONI**”) to be responsible for monitoring all aspects of the insurance industry. The ONI will be charged with gathering information, developing expertise, negotiating international agreements, coordinating policy in the insurance

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4 The level of any minimum threshold is not yet set. Industry lobbyist Todd Groome, chairman of the Alternative Investment Management Association, advocated mandatory registration for advisers with at least US\$500 million in assets under management, acknowledging, however, that there is nothing special about that number; and that a lower threshold of US\$300 million, for example, would cover approximately 80 percent of the industry. In light of the much smaller de minimis exceptions included in the current legislative proposals, it is more likely that the modest threshold eventually adopted, if any, would be closer to US\$50 million than US\$500 million.

5 Unlike the other pending legislative proposals that require private fund managers to register as investment advisers, the Hedge Fund Transparency Act requires the underlying pools of capital themselves to register as investment companies under the Investment Company Act (pursuant to a proposed new “lite” registration scheme). Registration as an investment company is particularly significant as it would trigger an event of default for many private pools of capital under various agreements and would also likely prompt other unintended consequences. Additionally, by requiring the registration of certain private funds, the bill would effectively require the advisers of such funds to register with the SEC under the Advisers Act because such advisers would no longer be able to claim an exemption from registration under Section 203(b)(3) of the Advisers Act.

sector and identifying the emergence of any issues that could contribute to a future crisis. Further, the Treasury will support proposals to modernize and improve insurance regulation consistent with the principles of effective insurance-related systemic risk regulation, strong capital standards, meaningful and consistent consumer protection, increased national uniformity, regulation of insurance companies and their affiliates on a consolidated basis, and international coordination.

- **Determine the Future Role of Fannie Mae, Freddie Mac, and the Federal Home Loan Bank system:** The Plan provides that the Treasury and the Department of Housing and Urban Development, in consultation with other government agencies, will engage in an initiative to devise recommendations and seek public input on the future of Fannie Mae and Freddie Mac (the “GSEs”) and the Federal Home Loan Bank system. The Plan highlights a number of options for reform of GSEs: (i) returning them to their previous status as GSEs with the paired interests of maximizing returns for private shareholders and pursuing public policy goals, (ii) gradually winding-down their operations and liquidation, (iii) incorporating their functions into a federal agency, (iv) involving the government in the regulation of the GSEs’ profit margins, setting guarantee fees and providing explicit backing for GSE commitments (i.e., a public utility model), (v) providing insurance for covered bonds and (vi) dissolving the GSEs into many smaller companies. The Treasury and the Department of Housing and Urban Development will report their recommendations to Congress and the American public at the time of the President’s 2011 budget.

## Establish Comprehensive Regulation of Financial Markets

The Plan proposes bringing the markets for all over-the-counter (“OTC”) derivative and asset-backed securities under a new regulatory framework that imposes transparency and improved market discipline.

- **Strengthen Supervision and Regulation of Securitization Markets:** The Plan makes several recommendations to address what the Administration considers a breakdown in credit underwriting standards in subprime and other residential mortgage markets and a broad relaxation in market discipline regarding the credit quality of loans that originators intended to distribute to investors through securitizations. The Plan proposes initiatives to address these deficiencies by requiring originators and sponsors of securitized assets to retain a portion of the securitized credit risk, changing the incentive structure of market participants, increasing transparency, strengthening credit agency performance, and reducing incentives for overreliance on credit ratings.

- **Enact regulations that require the originator or sponsor of a securitized credit exposure to retain an economic interest in a material portion of the credit risk of that credit exposure.** The Plan states that the federal banking agencies should enact regulations that require loan originators or sponsors to retain five percent of the credit risk of securitized exposures and prohibit the originator or sponsor from directly or indirectly hedging or otherwise transferring the risk it is required to retain under such regulations. The Plan contemplates that the federal agencies have a wide degree of authority with respect to such regulations, including the authority to raise or lower the five percent threshold and provide exemptions to the “no hedging” requirement.
- **Enact regulations to align the compensation of market participants with longer-term performance of underlying loans.** The Administration contends that the interests of securitization participants should be more closely aligned with the interests of their clients, borrowers and investors. Consequently, the Plan includes various measures that, if approved, would link compensation of participants, including brokers, dealers, originators, sponsors, underwriters and others involved in the securitization process, to longer-term performance. For example, the Plan states that fees and commissions received by loan brokers should be disbursed over time if asset quality problems later emerge and that, as proposed by the FASB, US Generally Accepted Accounting Principles should be amended to require originators to recognize income over time, as opposed to immediately at the inception of the transaction. If enacted, this method of compensating brokers, dealers, and underwriters whose primary role in securitizations is one of structuring and selling securities would mark a radical departure from the way such entities are compensated for other securities with equivalent or more risk than securitizations.
- **Increase transparency and standardization.** The Plan encourages the SEC to continue its current efforts to improve and standardize disclosure practices by originators, underwriters and credit rating agencies. In addition, the Plan provides that the SEC should be given the authority to require robust ongoing reporting by asset-backed securities issuers (e.g., loan-level data broken down by loan broker or originator and the nature of the compensation of the broker, originator or sponsor).
- **Many securitizations to be “on-balance sheet.”** The Plan calls for “many securitizations” to be consolidated on the originator’s balance sheet. The accounting consolidation requirement will remove the incentive for many securitizers, who previously used securitization to enhance their financial appearance by reducing the amount of assets and liabilities on their balance sheet.

- **Strengthen regulation of credit rating agencies.** The Plan also encourages the SEC to continue its current effort to strengthen the regulation of credit rating agencies. The Plan specifically highlights that credit rating agencies should be required to maintain robust policies and procedures for managing and disclosing conflicts of interest, and publicly disclose substantially more information (e.g., precisely what their credit ratings are designed to assess, material risks not reflected in the ratings, and information about their methodologies for rating structured finance products to allow users of the information to reach their own conclusions about the efficacy of such methodologies).
- **Comprehensively Regulate All OTC Derivatives, Including Credit Default Swaps:** The Plan makes a number of proposals to help achieve four broad policy objectives regarding OTC derivatives: (i) preventing activities in those markets from posing risk to the financial system, (ii) promoting the efficiency and transparency of those markets, (iii) preventing market manipulation, fraud and other market abuses, and (iv) ensuring that OTC derivatives are not improperly marketed to unsophisticated parties. The Plan proposes that the Commodities Exchange Act (the “**CEA**”) be amended to require clearing of all standardized OTC derivatives through regulated central counterparties (“**CCPs**”). Accordingly, regulators will need to require that CCPs impose robust margin requirements and other necessary risk controls. The Administration believes that a CCP clearing procedure, moving the standardized part of these markets onto regulated exchanges and regulating transparent electronic trade execution systems for OTC derivatives, will improve market efficiency and price transparency. Moreover, the Plan states that all OTC derivatives dealers should be subject to an appropriate regime of supervision and regulation, including conservative capital requirements, business conduct standards, reporting requirements, and conservative requirements relating to initial margins on counterparty credit exposures. The Administration also supports amending the CEA and other securities laws, as necessary, to provide the CFTC and the SEC with the authority to regulate fraud, market manipulation and other abuses and the ability to impose record-keeping and reporting requirements on all OTC derivatives.
- **Harmonize the Regulation of Futures and Securities:** Although the Plan does not contemplate the consolidation of the CFTC and the SEC as many had speculated, it does propose that the CFTC and the SEC make recommendations to Congress for changes to statutes and regulations that would harmonize the regulation of futures and securities and promote coordination between the two agencies going forward. Such changes should eliminate jurisdictional uncertainties and ensure that economically equivalent instruments are regulated similarly, regardless of which agency has jurisdiction. In light of the fact that the CFTC employs a “principles-based approach” and the SEC employs a “rules-based approach,” the two agencies should build a common basis for market regulation through an agreement on precise principles of regulation that sufficiently allow for innovations consistent with such principles. The Administration recommends that the two agencies complete a report to Congress by September 30, 2009 that identifies all existing conflicts in statutes and regulations regarding similar types of financial instruments and either explains the need for such differences or makes recommendations to eliminate such differences. Any differences that the agencies cannot agree on by September 30 should be referred to the new Council, which would be required to report its recommendations to Congress within six months of its formation.
- **Strengthen Oversight and Functioning of Systemically Important Payment, Clearing and Settlement Systems and Related Activities:** The Administration proposes that the Federal Reserve be assigned the responsibility and authority to conduct oversight of systemically important payment, clearing and settlement systems (“**Covered Systems**”) and related activities of financial firms (“**Covered Activities**”). The Plan states that the Administration will propose legislation that broadly defines the characteristics of Covered Systems and Covered Activities and sets objectives and principles for their oversight. The Plan also proposes that Congress direct the Federal Reserve, in consultation with the Council, to identify Covered Systems and Covered Activities, set risk management standards for their operation, collect information necessary to assess the systemic importance, safety and soundness of the system, and compel corrective action. The Federal Reserve would have the responsibility and authority for ensuring consistent oversight of all Covered Systems and Covered Activities. However, if a Covered System is subject to comprehensive regulation by a federal market regulator (the CFTC or SEC), such market regulator will remain its primary regulator. Similarly, compliance by a financial firm with Federal Reserve standards regarding Covered Activities will be enforceable administratively by the firm’s primary federal regulator.
- **Strengthen Settlement Capabilities and Liquidity Resources of Systemically Important Payment, Clearing and Settlement Systems:** The Administration also recommends that Congress grant the Federal Reserve authority to provide Covered Systems with access to Reserve Bank accounts, financial services and the discount window. Most Covered Systems depend on commercial banks to perform critical services, such as the liquidity necessary to convert collateral into funds to complete settlement. These dependencies create the risk that a Covered System cannot meet its obligations to participants if the bank that provides it with critical services is unwilling or unable to provide liquidity. The Administration believes that such risk would be eliminated by providing direct access to Reserve Bank accounts and financial services and, for emergency purposes, access to the discount window.

## Protect Consumers and Investors from Financial Abuse

In order to prevent abusive practices, the Plan offers a number of measures that aim to reform the current protections in place, including legislative, regulatory, and administrative reforms to promote transparency, simplicity, fairness, accountability, and access to consumer financial products and services. The Plan also proposes the creation of a single regulatory agency, the CFPA, with supervisory, examination, and enforcement authority for protecting consumers, and grants new authority and resources to the Federal Trade Commission and the SEC.

- **Create a New Consumer Financial Protection Agency:** The CFPA would be an independent agency dedicated to protecting consumers in the financial products and services markets, other than investment products and services already regulated by the SEC or CFTC. The CFPA would have broad jurisdiction and would be granted consolidated authority over the closely related functions of rule-making, supervising and examining institutions' compliance, and administratively enforcing violations in cooperation with the Department of Justice. The CFPA would reduce gaps in federal supervision, improve coordination among the states, set higher standards for financial intermediaries, and promote consistent regulation of similar products.
  - **A new proactive approach to disclosure.** The Plan proposes that the CFPA require that all disclosures and communications with consumers be reasonable, balanced in their presentation of benefits, and clear and conspicuous in their identification of costs, penalties, and risks. Through the use of better technology, such disclosures should be more dynamic and relevant to the individual consumer.
  - **Defining Standards for "Plain Vanilla" Products.** The Plan recommends that the CFPA require all providers and intermediaries to offer "plain vanilla" products, which are simpler and have straightforward pricing, prominently alongside whatever other products they choose to offer. It also recommends that the CFPA should define the standards for such products.
  - **Restrictions on Product Terms and Provider Practices.** To assure fairness, the Plan authorizes the CFPA to place tailored restrictions on product terms and provider practices, if the benefits outweigh the costs. Accordingly, the CFPA would regulate unfair, deceptive, or abusive acts or practices. Moreover, the Plan proposes to authorize the CFPA to impose empirically based duties of care on financial intermediaries and to apply consistent regulation to similar products.

- **Enforcement of Fair Lending Practices.** In order to promote wide access to financial services, the Plan recommends that the CFPA enforce fair lending laws, including rigorous application of the Community Reinvestment Act, to ensure that low-income communities have access to responsible financial services.

- **Strengthen the Framework for Investor Protection:** The Plan proposes certain revisions to the federal securities laws to modernize the financial regulatory structure, with an emphasis on expanding the SEC's authority to promote transparency in disclosure to investors. It also envisions new tools for the SEC to promote fair treatment of investors, including establishing a fiduciary duty for broker-dealers offering investment advice and harmonizing the regulation of investment advisers and broker-dealers. The Plan also states that financial firms and public companies should be accountable to their clients and investors. As such, the Plan expands protections for whistleblowers, expands sanctions available in enforcement actions, harmonizes liability standards, and requires non-binding shareholder votes on executive compensation packages. In addition, to address potential gaps in consumer and investor protection, the Plan proposes the creation of a Financial Consumer Coordinating Council, comprised of the heads of the SEC, the Federal Trade Commission, the Department of Justice, and the CFPA, that would meet at least quarterly to identify gaps and facilitate the coordination of consumer protection efforts. Finally, the Plan seeks to promote individuals' retirement security by strengthening employment-based and private retirement plans and encouraging adequate savings.

## Provide the Government with the Tools it Needs to Manage Financial Crises

Taking lessons from the financial crises of the past year, the Plan highlights the need for comprehensive reform of how the government can manage a financial crisis. Currently, the government has only two options: to provide emergency funding to a failing firm or to allow the firm to declare bankruptcy. The Plan attempts to address this lack of alternatives by providing the government with better tools to handle crises when they arise. As such, the Plan proposes the following:

- **Create a Resolution Regime for Failing BHCs:** The Plan proposes the creation of a resolution regime to avoid the disorderly resolution of failing BHCs, including Tier 1 FHCs. This would not replace the bankruptcy procedures in the normal course of business. However, this proposed regime would be used only if a disorderly resolution would have serious adverse effects on the financial system or the economy. The regime would be modeled on the existing resolution regime for insured depository institutions under the Federal Deposit Insurance Act.

■ **Amend the Federal Reserve's Emergency Lending Authority:**

The Administration also announced that it will propose legislation to amend Section 13(3) of the Federal Reserve Act to require the prior written approval of the Secretary of the Treasury for any extensions of credit by the Federal Reserve to individuals, partnerships, or corporations in "unusual and exigent circumstances" to provide appropriate accountability for any future governmental financial rescue efforts.

## Raise International Regulatory Standards and Improve International Cooperation

The Administration recognizes that although financial regulation is still set largely in a national context, financial problems spread quickly across national boundaries. In order to prevent financial institutions from moving their activities to jurisdictions with looser regulatory standards, the Administration announced that the United States is leading an effort to coordinate international financial policy through the G-20, the Financial Stability Board ("FSB"), and the Basel Committee on Banking Supervision ("BCBS"). This coordination focuses on four core issues:

(1) regulatory capital markets; (2) oversight of global financial markets; (3) supervision of internationally active financial firms; and (4) crisis prevention and management. To address these issues the Plan proposes the following:

- **Strengthen the International Capital Framework:** The Plan recommends that the BCBS continue to improve the amended Basel Accord, known as Basel II, by (i) refining the risk weights applicable to the trading book and securitized products by 2010; (ii) issuing guidelines to harmonize the definition of regulatory capital by the end of 2009; (iii) introducing a supplemental leverage ratio as recommended by the G-20; and (iv) completing an in-depth review of the Basel II framework and implementing by the end of 2009 the G-20's recommendations to mitigate procyclicality, including a requirement for banks to build capital buffers in good times that they can draw down when conditions deteriorate.
- **Improve the Oversight of Global Financial Markets:** The Administration urges national authorities to promote the standardization and improved oversight of OTC derivatives markets in compliance with the G-20 commitment and to advance these goals through international coordination and cooperation. The Plan highlights in particular the use of central counterparties as a means to meet the G-20 commitment.
- **Enhance Supervision of Internationally Active Financial Firms:** The Plan recommends that the FSB and national authorities implement G-20 commitments to strengthen arrangements for international cooperation on supervision

of global financial firms. To this end, supervisory colleges have been established for the thirty most significant global institutions. Additional colleges will be established for other significant cross-border firms.

- **Reform Crisis Prevention and Management Authorities and Procedures:** The Plan proposes that the United States and its international counterparts should improve mechanisms for the cross-border resolution of financial firms by: (i) creating a flexible set of powers for resolution authorities to provide for continuity of significant functions; (ii) furthering the development of mechanisms for cross-border information sharing among regulatory authorities; (iii) enhancing the effectiveness and efficiency of crisis management and resolutions under the currently prevailing 'separate entity' approach; and (iv) enhancing the effectiveness of existing rules for the clearing and settlement of cross-border financial contracts and large value payments transactions. To improve cross-border crisis management more broadly, national regulators, including in the United States, are implementing the FSB principles endorsed by the G-20 Leaders.

In addition to committing to these four core priorities, the Plan announces the United State's commitment to implementing the rest of the regulatory reform agenda adopted by the G-20 Leaders in their April Summit. The United States will host the third Leaders' Summit in Pittsburgh in September 2009, and would like to see progress made on the rest of the issues addressed in the G-20 *Declaration on Strengthening the Financial System*. This includes:

- **Strengthening the Financial Stability Board:** The Administration recommends that the FSB complete its restructuring and institutionalize its new mandate to promote global financial stability by September 2009.
- **Strengthening Prudential Regulations:** The Administration also recommends that the BCBS improve liquidity risk management standards for financial firms and that the FSB work with the Bank for International Settlements and standard setters to develop macroprudential tools.
- **Expanding the Scope of Regulation:** The Plan proposes that the Federal Reserve develop rules to guide the identification of foreign financial firms as Tier 1 FHCs. These would be similar to the rules identifying domestic Tier 1 FHCs. The Federal Reserve, in consultation with Treasury, would also determine the requirements for foreign firms that seek FHC status. In addition, the Plan seeks to expand regulation to hedge funds as it urges national authorities to require hedge funds or their managers to register and disclose the information necessary to evaluate their individual or collective risks.

- **Introducing Better Compensation Practices:** The Administration urges national authorities to create guidelines to align compensation with long-term shareholder value and to promote compensation structures that do not provide incentives for excessive risk taking. The Plan recommends that the BCBS integrate the FSB principles on compensation into its risk management guidance by the end of 2009.
- **Promote Stronger Standards in the Prudential Regulation, Money Laundering/Terrorist Financing, and Tax Information Exchange Areas:** The Plan affirms the United States' commitment to raise the global standards in this area through greater use of objective assessments, due diligence, and objective peer reviews. As such, the United States has put forth a "Trifecta" initiative to that effect, which has been endorsed by the G-20 London Summit Declaration. The United States will implement the updated peer review process of the International Cooperation Review Group and will also work with the Financial Action Task Force to address non-compliant jurisdictions.
- **Improving Accounting Standards:** The Plan recommends that by the end of 2009 accounting standard setters (i) clarify and make consistent the application of fair value accounting standards, including the impairment of financial instruments; (ii) improve accounting standards for loan loss provisioning that would make it more forward looking; and (iii) make substantial progress toward development of a single set of high quality global accounting standards.
- **Tightening Oversight of Credit Rating Agencies:** Finally, the Plan urges national authorities to enhance their regulatory regimes to effectively oversee the credit rating agencies, consistent with international standards and the recommendations of the G-20 Leaders. Specifically, national authorities should enforce compliance with their oversight regime and oversee all credit rating agencies whose ratings are used for regulatory purposes consistent with the IOSCO Code of Conduct Fundamentals for credit rating agencies.

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