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HIGHLIGHTS OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT OF 2010

On July 15, 2010, Congress completed passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act") and the President is expected to sign it this week. The final impact of the Act on the financial services industry will not be known until scores of final regulations have been issued by numerous agencies but much can be foreseen based only on the statutory text. Milbank will be releasing a series of client alerts during the coming weeks on particular aspects of the Act of importance to our clients. In the meantime, highlights of the likely impact of the Act on the financial services industry generally are outlined below:

1. **Newly regulated entities and products**. The Act contains provisions that regulate financial products and market participants for the first time.

   a. **Swaps**. The swaps market will undergo a major overhaul as the result of Title VII of the Act. Among other things, the Act requires (i) swap dealers and major swap participants to register with the Commodity Futures Trading Commission (the "CFTC"), (ii) swaps to be cleared unless one of the parties to the transaction is not a financial entity and uses swaps to hedge or mitigate commercial risk, (iii) cleared swaps to be traded on an exchange or board of trade, and (iv) swap dealers and major swap participants to require counter-parties to post margin on un-cleared swaps. Dealers and participants in securities-based swaps will be subject to similar regulation by the Securities and Exchange Commission (the "SEC"). Regulations should resolve numerous unanswered questions including what entities fall within the definition of swap dealer and whether margin must be posted by end-users.

   b. **Private fund managers**. Managers of hedge funds, private equity and certain other private investment funds will be required to register with the SEC and will become subject to additional requirements under the Investment Advisers Act. Although the funds managed by these managers will not themselves be required to register, their managers will be required to provide the SEC with information about the funds' investments, strategies and performance. Regulations will determine how much information will have to be provided. Managers of venture capital funds will be exempt from registration; the SEC is to define by regulation what constitutes a venture capital fund.

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c. **Non-banking financial companies**. Systemically significant non-banking financial companies will become subject to oversight and supervision by the Board of Governors of the Federal Reserve System (the "FRB"). Requirements to be imposed on these entities will include capital and liquidity limitations. Regulations to be issued by the FRB will provide the criteria to determine what entities are to be designated systemically significant non-banking financial companies.

2. **Prohibited activities**. The Act restricts regulated banks and bank holding companies from engaging in certain activities that Congress deemed too risky.

a. **Swap push-out**. Insured depository institutions that are swap dealers and major swap participants will be forced to "push-out" their swap activities into a non-bank affiliate under threat of losing access to the discount window and other government assistance. Swap transactions entered into for hedging or risk-mitigation purposes or that refer only to interest rates or other instruments in which a bank may invest for its own account may remain in the bank.

b. **Fund investments**. Bank holding companies and their bank and non-bank subsidiaries will no longer be permitted to invest in, act as general partner of or lend their name to hedge, private equity and other private investment funds. To permit bank holding companies and their subsidiaries to continue to manage and advise such funds, limited investments will be permitted of up to three percent of the total investment in the fund. Investments in funds are also permitted if the investment is made by a non-U.S. bank holding company in a non-U.S. fund if interests in the fund are not sold to U.S. persons. Regulations to be issued by the FRB should clarify the scope of a prohibition in the Act on investments that "function as an evasion" of the prohibition.

c. **Proprietary trading**. Bank holding companies and their bank and non-bank subsidiaries will no longer be permitted to engage in "proprietary trading." Proprietary trading is defined as engaging as a principal for the trading account of the entity in any transaction to purchase or sell a security, derivative, futures contract, an option on any of the foregoing or any other instrument that the entity's federal regulator may determine. Notwithstanding these prohibitions, the Act permits, among other things, (i) the purchase and sale of government and government agency securities, (ii) the purchase and sale of securities in connection with underwriting or market-making activities, (iii) hedging and risk-mitigation activities, and (iv) proprietary trading conducted by a non-U.S. holding company outside the United States.

d. **Risk retention**. No securitizer, defined as a person that "organizes and initiates" an asset-backed securities transaction, may sell securities in a securitization without, together with any originator of the loans held by the issuer, retaining five percent of the credit risk of the assets backing the securities except where those assets are qualified residential mortgages. The SEC and the Federal banking agencies are charged with issuing regulations that prescribe the permissible form of risk-retention, allow credit risk of less than five percent to be retained if certain underwriting standards are met and prescribe standards for risk to be retained in the case of collateralized debt obligations.

3. **Capital**. Several provisions in the Act point to increased capital requirements for banking and other financial institutions. All of these requirements will need to be reconciled with the results of the Basel Committee's final decisions on Basel III requirements.

a. **Prudential standards**. The FRB is required to establish prudential standards for risk-based capital and leverage for systemically significant non-bank financial companies and bank holding companies with more than $50 billion in consolidated assets. These standards must be more stringent than those for other financial companies. The standards are to include liquidity requirements and concentration limits. The same standards are also to be developed by the FRB for foreign non-bank financial companies and foreign bank holding companies albeit with due regard to the principal of national treatment.

b. **Contingent capital**. Following a two-year study on the subject of contingent capital, the FRB may issue regulations that require systemically significant non-bank financial companies and bank holding companies with more than $50 billion in consolidated assets to maintain contingent capital that is convertible into equity in times of financial stress.

c. **Trust preferreds**. Under an amendment offered by Senator Collins, bank and thrift holding companies will no longer be permitted to count the proceeds of their trust preferred securities as Tier 1 capital. A last-minute compromise grandfathers all trust preferreds issued by bank and thrift holding companies with assets of less than $15 billion as of December 31, 2009. Holding companies with assets in excess of $15 billion must gradually begin deducting trust preferred securities from Tier 1 capital during a three-year period beginning January 1, 2013.

4. **Resolution of financial firms**. The Act authorizes the FRB and the Federal Deposit Insurance Corporation (the "FDIC") by a two-thirds vote to recommend that the Treasury Department place a non-bank financial company or bank holding company into receivership. It authorizes the FRB and the SEC to do the same with respect to a broker-dealer and the FRB and the director of the Federal Insurance Office (see para. 5.d below) to do the same in the case of an insurance company. The Secretary of the Treasury must place the company into receivership if he determines that the resolution of the company under otherwise applicable federal or state law "would have serious adverse effects on financial stability in the United States." The Secretary of the Treasury is to appoint the FDIC as receiver and to seek a court order to do so if the company does not consent. The Act provides for the involvement of a Securities Investor Protection Corporation trustee in the case of the resolution of a broker-dealer and of a state insurance commissioner in the case of the resolution of an insurance company.

5. **Regulatory agencies**. The Act creates three new federal regulatory agencies and eliminates one.

a. **Oversight council**. A new Financial Stability Oversight Council is established to identify risks to the financial stability of the United States, to promote market discipline and to respond to emerging threats to the U.S. financial system. Its voting members are the heads of the various federal financial regulatory agencies and its chair is the Secretary of the Treasury. Among its duties are to recommend to the FRB prudential standards to be applied to systemically significant non-bank financial companies and bank holding companies.

b. **Consumer protection**. A new Bureau of Consumer Financial Protection is established to exercise exclusive rulemaking authority over a wide range of Federal consumer protection laws and to share with their prudential regulators examination authority regarding compliance with those laws by banks with more than $10 billion in assets. The Bureau has primary enforcement authority over these banks and over non-depository institutions such as mortgage and consumer finance companies. The Bureau's rules can be rejected by a two-thirds vote of the Financial Stability Oversight Council.

c. **Thrifts**. The Office of Thrift Supervision is merged into the Office of the Comptroller of the Currency. The thrift charter is not abolished. Responsibility for the supervision and regulation of savings and loan holding companies is transferred to the FRB.

d. **Insurance**. A new Federal Insurance Office is established within the Treasury Department. Its functions are limited to monitoring the insurance industry and consulting with state insurance commissioners about insurance matters of national importance. Its director is to serve in an advisory capacity on the Financial Stability Oversight Council.

6. **Preemption**. The Act provides that a state consumer protection law is preempted if the state law "prevents or significantly interferes with" the exercise by a national bank of its powers, thereby preserving the *Barnett* standard now in effect. It also provides that a state law is preempted if would have a discriminatory effect

on a national bank or Federal savings association or is preempted by any other Federal law. The OCC must make a preemption determination only on a case-by-case basis with respect to a particular state law or other state law with substantively equivalent terms.

7. **Interchange fees**. The Act authorizes the FRB to issue regulations governing the amount of any interchange transaction fee that an issuer may charge to ensure that is reasonable and proportional to the cost incurred.

8. **Insurance**. The assessment basis on which FDIC insurance premiums will be calculated is changed from one based on deposit liabilities to one based on average consolidated assets. The Act permanently increases the insured amount per depositor to $250,000 from $100,000.

9. **Miscellaneous**. The Act contains numerous provisions that will have an impact on the day-to-day business of banking organizations but that have received relatively little attention in the press. These include provisions (i) that expand the types of transactions that will be deemed covered transactions subject to the transactions-with-affiliates restrictions of section 23A of the Federal Reserve Act; (ii) that require financial holding companies to obtain prior FRB approval before acquiring a nonbank with assets greater than $10 billion, (iii) that require financial holding companies themselves to be well capitalized and well managed in order to maintain their financial holding company status, (iv) that establish a moratorium on new industrial banks, credit card banks and trust banks that are owned by commercial firms, (v) that include derivative and repo transactions in those transactions that are subject to lending limits, (vi) that remove restrictions on de novo interstate banking, (vii) that strengthen FRB oversight and examination authority over nonbank subsidiaries of bank holding companies, including those functionally regulated by other agencies, (viii) that subject savings and loan holding companies to capital requirements and source-of-strength obligations, and (ix) that repeal the ban on the payment of interest by banks on demand deposits maintained by businesses.

The Act contains a variety of effective dates for the various provisions discussed above, ranging from the date of enactment to five years from the date of enactment. Regulations must be proposed and adopted by regulators sometimes by deadlines prescribed by the Act, often by no set date. Milbank will be following closely the implementation of the Act and will continue to issue alerts when they are warranted.

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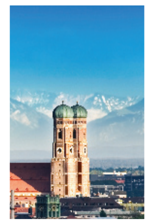

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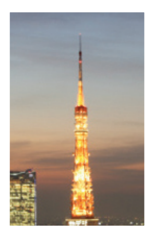

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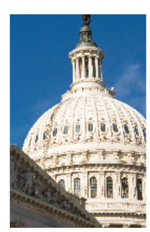

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