

FINANCIAL REGULATORY REFORM POLICY UPDATE (PRELIMINARY)

From: Patton Boggs Financial Services Policy Group
Date: December 4, 2009
Subject: House Financial Services Committee Chairman Frank Introduces
“The Wall Street Reform and Consumer Protection Act” (H.R. 4173)

On December 2, 2009, U.S. House Financial Services Committee Chairman Barney Frank (D-MA) introduced a comprehensive regulatory reform package entitled “The Wall Street Reform and Consumer Protection Act” (H.R. 4173) which would overhaul of the financial services regulatory system. The following is a preliminary summary of the proposal based on an initial review. Further analysis will be included in a follow-up report.

I. Executive Summary

Chairman Frank’s legislation is a comprehensive package that encompasses individual bills already passed out of the House Financial Services Committee (“HFSC”) and that reflects portions of the Obama Administration’s previously announced initiatives for an overhaul of the U.S. financial regulatory framework. Key components of the legislation include the creation of a systemic risk regulator, creation of a resolution authority, expanded powers of the Federal Reserve, establishment of a consumer protection agency for financial products, regulation of investment advisers and derivatives, insurance companies, credit rating agencies, among myriad other provisions.

Timing. Chairman Frank hopes to offer the legislation to the House floor by mid-December 2009. However, the bill would still need to be reconciled with a Senate proposal, the “Restoring American Financial Stability Act” (“RAFSA”), which has yet to be reported out of the U.S. Senate Banking Committee or the Senate Agriculture Committee which has jurisdiction over parts of the derivatives piece of this legislative package. Assuming House passage between now and the end of the year and assuming that the Senate acts on their legislation sometime in the beginning of 2010, negotiations to reconcile Senate and House versions are anticipated to continue through early to potentially mid-2010, as numerous key differences between the House and Senate versions (further discussed below) remain.

II. Key Elements of the Legislation

The following is a summary of selected key provisions of the legislation, including (1) expanded role of the Federal Reserve and consolidation of OTS into OCC; (2) creation of a systemic risk regulator; (3) creation of a resolution authority; (4) creation of a Consumer Financial Protection Agency; (5) regulation of credit rating agencies; (6) regulation of the insurance industry; (7) increased investor protection; (8) regulation of derivatives; (9) regulation of investment advisers; and (10) executive compensation provisions.

1. **Expanded Role of the Federal Reserve; Consolidation of OTS into OCC**

Chairman Frank's proposal would grant the Federal Reserve the power to direct any large financial holding company to reduce its size by selling or transferring assets or curtailing certain activities if the Federal Reserve determines there is "an existing or foreseeable threat to the safety and soundness of such company or to the financial stability of the United States." It also empowers the Federal Reserve to set concentration limits for large financial holding companies, prohibiting the companies from having credit exposures to purchase an unaffiliated entity that exceeds 25 percent of the holding company's capital stock and surplus. Additionally, the legislation requires that the Board of Governors of the Federal Reserve (and the FDIC and Secretary of the Treasury) approve the FDIC's extension of credit or guarantee of obligations of solvent insured depository institutions or other solvent companies. The legislation also gives the Federal Reserve the power to force a financial holding company into bankruptcy if the Federal Reserve determines that the entity is critically undercapitalized.

The legislation restricts Section 13(3) of the Federal Reserve Act to provide that in "unusual and exigent circumstances," the Board of Governors of the Federal Reserve System may authorize discounted notes, drafts and bills of exchange for any individual, partnership or corporation provided that certain provisions are met. Such action is only authorized as part of a broadly available credit or other facility and not made available for only a single, specific individual, partnership or corporation. Further, before discounting for an individual, partnership or corporation, the Federal Reserve Bank must show that the entity is unable to secure adequate credit from other banking institutions.

However, several additional provisions specifically limit the Federal Reserve's power, including the creation of a Consumer Financial Protection Agency, which would strip the Federal Reserve of its consumer oversight powers. An amendment by Rep. Paul (R-TX) and Rep. Grayson (D-FL) requires an audit of the Federal Reserve's lending programs and monetary policies to be completed within 12 months of the enactment of the legislation.

By contrast, Chairman Dodd's proposal in the Senate would strip powers from the Federal Reserve, and would instead create a Financial Institutions Regulatory Administration ("FIRA") as a single prudential regulator by consolidating the oversight duties of the Office of Thrift Supervision ("OTS"), the Office of the Comptroller of Currency ("OCC"), the state bank supervisory functions of the Federal Reserve and the Federal Deposit Insurance Corp ("FDIC"), and the bank holding company authority supervision of the Federal Reserve.

Consolidation of OTS into OCC. The legislation would integrate the Office of Thrift Supervision ("OTS") into the Office of Comptroller of Currency ("OCC"). The OCC would have a new division of thrift supervision which will have all of the powers that had previously been vested in the OTS. The OCC and the FDIC would be required to work together to provide improved regulation of banking institutions and to provide a report one year after integration of the OTS into the OCC discussing the steps taken to improve regulation.

2. Systemic Risk Regulator

The legislation would establish a Financial Services Oversight Council (“FSOC”) as a systemic risk regulator to identify financial companies and financial activities that pose a threat to financial stability. The FSOC would have voting members, including the Secretary of the Treasury (who shall serve as the Chairman of the Council), the Chairman of the Board of Governors of the Federal Reserve, and the Comptroller of the Currency, among others. The legislation would also have non-voting members, including a state insurance commissioner and a state banking supervisor.

The legislation would empower the FSOC to act as a systemic risk regulator, monitoring and implementing tougher controls on these systemically significant bank and nonbank financial institutions that could cause systemic risk in the event of a failure. Essentially, it would subject those systemically significant companies and activities to more stringent prudential oversight, standards and regulation.

Additionally, the FSOC would advise Congress on financial regulation, making recommendations on how to enhance the integrity, efficiency, orderliness, competitiveness, and stability of the United States financial markets. It would issue formal recommendations for agencies with members on the FSOC to adopt heightened prudential standards for firms they regulate to mitigate risk. Finally, the legislation would facilitate information-sharing and mitigate jurisdictional or regulatory disputes between agencies with members on the council.

Divestiture Authority for “Too Big to Fail.” The legislation would give the government the ability to preemptively limit the size, complexity and risk of any financial institution. It grants authority to the FSOC to break up firms posing too great of a risk to the economy and orders the divestiture of assets, regardless of the firm’s health.

Generally, this power will be limited to situations where the firm is so large and so interconnected that the United States economy would still be threatened even if the resolution authority followed the firm’s failure plan and wound the firm down in the event of a collapse. The provision requires that regulators consider an institution’s size, exposure, leverage and interconnectedness when deciding whether this extreme action should be taken.

3. Resolution Authority

The legislation would establish a resolution authority under the FDIC to wind down large, financially-troubled non-bank financial institutions. The winding down process would be facilitated by a \$150-billion dollar systemic dissolution fund. The fund would allow the FDIC, with the approval of the Treasury Department and Federal Reserve, to make a loan to or offer guarantees for a solvent company if necessary to “prevent financial instability during times of severe economic distress.”

Assessments to Pay for the Systemic Risk Dissolution Fund; Changes to the Federal Deposit Insurance Fund. The dissolution fund will be funded by fees charged to financial companies with more than \$50 billion in assets and hedge funds with more than \$10 billion in assets

under management on a consolidated basis. These fees will be based upon individual risk assessments conducted by the FDIC and the Securities and Exchange Commission (“SEC”).

The FDIC and the SEC shall establish a risk matrix to establish the assessments to each individual financial company that considers many factors, including: (1) the actual or expected risk of losses to the Fund; (2) the economic conditions generally affecting financial companies; (3) the type of financial company being assessed; and (4) the extent to which the financial company has benefitted or would likely benefit from the dissolution of another financial company through this process. In establishing the assessment system for the Fund, the FDIC and SEC are able to differentiate among financial companies to “ensure that the assessments charged equitably reflect the risk posed to the Fund by particular classes of financial companies.”

The fund would be capped at \$150 billion, with a provision allowing the regulators to raise another \$50 billion with the approval of Congress, the US Treasury and the President. The FDIC dissolution authority ends on December 31, 2013, unless extended by Congress and the President.

4. Consumer Financial Protection Agency

The legislation would establish a Consumer Financial Protection Agency (“CFPA”) responsible for rulemaking and the examination and enforcement of regulation on financial institutions that provide consumers with financial products and services. The independent CFPA would be headed by a Director serving a five year term, who is Presidentially appointed and Senate confirmed. The CFPA would have rulemaking authority transferred from the consumer banking laws of the Federal Reserve and other Federal Banking agencies. The CFPA would have broad rulemaking authority to address unfair, deceptive and abusive acts and practices that it identifies in financial institutions.

Carve-Out for SEC-Regulated Persons (e.g. Broker Dealers, Investment Advisers, Investment Companies). The SEC would retain its authority to adopt rules, initiate enforcement proceedings, or take any other action with respect to a person regulated by the Securities and Exchange Commission that acts in a “registered capacity”. The CFPA would not have authority to exercise any power to enforce this title with respect to such person regulated by the Securities and Exchange Commission. The persons in this carve-out include, for example: a broker or dealer registered under the Securities Exchange Act of 1934; an investment adviser registered under the Investment Advisers Act of 1940; an investment company required to be registered under the Investment Company Act of 1940; a national securities exchange required to be registered under the Securities Exchange Act of 1934; a clearing corporation registered under the Securities Exchange Act of 1934; any municipal securities dealer registered with the SEC; any national securities exchange registered under the Securities Exchange Act of 1934.

Preemption. The bill provides, among other things, that: (1) the federal regulator may preempt state consumer financial protection laws after a written finding by the Office of the Comptroller of Currency that the state law “prevents or significantly interferes” with a federally regulated bank or thrift’s exercise of its powers. The finding must be done by regulation or order on a case-by-case basis; (2) federal regulators would be required to consult with CFPA to determine that consumers will still be protected under federal law if the state law is preempted; and (3) operating

subsidiaries of national banks and federal thrifts that are state-chartered business entities will be subject to state consumer protection laws. In addition, state attorneys general would be authorized to enforce CFPB regulations, provided they consult with the CFPB prior to initiating such action.

CFPB Back-Up Role for Smaller Banks with Assets Less than \$10 Billion from CFPB Examination, Enforcement. The measure gives the CFPB a back-up role for smaller banks with assets of less than \$10 billion and credit unions with assets of less than \$1.5 billion. These smaller banks and credit unions would have CFPB regulations generally enforced by their functional regulators instead of the CFPB. However, the legislation gives the CFPB backstop powers, including the ability to remove a functional regulator as consumer compliance regulator on an institution-by-institution basis if it determines the regulator failed to adequately carry out consumer compliance supervision with regard to the particular institution.

5. Credit Rating Agencies

The proposed legislation, which is similar to the version offered as a standalone piece by Rep. Paul Kanjorski (D-PA), would provide for increased regulation of nationally recognized statistical rating organizations (“NRSRO”). Among its provisions, it would require the SEC to conduct reviews of NRSROs for the establishment of certain internal controls, methodologies, and due diligence in the issuance of credit ratings. Further, under the legislation, the SEC must promulgate rules managing conflicts of interest in the issuance of credit ratings by such NRSROs.

With respect to internal governance, the legislation would require at least one-third of the board of directors of each NRSRO to be independent, with no less than two independent directors seated on a board. Independent director compensation may not be linked to the business performance of the NRSRO, and the term of office for such independent directors must be for a pre-agreed, non-renewable, fixed period not to exceed five years. Under the proposal, each NRSRO must designate a compliance officer charged with ensuring the organization’s compliance with required policies and procedures and, in consultation with the board, resolving any conflicts of interest. The designated compliance officer reports directly to the NRSRO’s board.

The legislation is designed to increase transparency and accountability to the credit rating agencies, providing additional information to all market participants, including issuers, investors and companies who rely upon their credit rating to do business. Along with each credit rating issued, the NRSRO must provide a report “for free or a reasonable fee” that discloses, among other things, the main assumptions included in constructing procedures and methodologies, potential shortcomings of the credit ratings, information on the reliability, accuracy, and quality of the data analyzed, and any other information required by the SEC.

The legislation would also establish within the SEC an office responsible for administering those rules and regulations governing NRSROs. Additionally, the SEC would be required to establish a Credit Ratings Agency Advisory Board to serve as an advisory panel to the SEC in its implementation of the provisions of the Accountability and Transparency in Rating Agencies Act. The bill would require the SEC to study ratings standardization, including: the feasibility and desirability of (1) standardizing credit ratings terminology, so that all credit rating agencies issue credit ratings using identical terms; (2) standardizing the market stress conditions under which

ratings are evaluated; (3) requiring a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations under standardized conditions of economic stress; and (4) standardizing credit rating terminology across asset classes, so that named ratings shall correspond to a standard range of default probabilities and expected losses independent of asset class and issuing entity. Within a year after enactment of the bill, the SEC is required to transmit to Congress a report containing the findings of the study and recommendations of the SEC.

6. Regulation of the Insurance Industry

The legislation would establish a Federal Insurance Office (“FIO”) in the Department of Treasury to monitor and regulate the insurance system at the federal level, while preserving state regulation. The FIO would share its authority with the Office of the U.S. Trade Representative (“USTR”) in supervising the insurance system. The FIO would also have the authority to manage the global insurance system and represent the U.S. internationally. Additionally, the FIO Director would be required to conduct a study and present a report one year after FIO creation. The report would assess ways to modernize insurance regulations based on the six principles given by the Obama Administration.

The FIO would be empowered to broadly monitor insurance, including: (1) identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system; (2) to recommend to Federal Reserve System or other systemic risk regulator that it designate an insurer, including its affiliates, as an entity subject to heightened regulation; (3) to assist the Treasury Secretary in administering the Terrorism Insurance Program; (4) to coordinate Federal efforts and develop Federal policy on prudential aspects of international insurance matters, including representation as appropriate in the International Association of Insurance Supervisors and assisting the Secretary in negotiating international insurance agreements on prudential measures; (5) to determine whether State insurance measures are preempted by international insurance agreements on prudential measures; and (6) to consult with the States regarding insurance matters of national importance and prudential insurance matters of international importance.

7. Investor Protection

The provisions of the Investor Protection Act are designed to provide the SEC with additional oversight authority to better protect investors and prevent future fraudulent or abusive practices revealed in the recent Madoff and Stanford Financial scandals. Most notably, the Investor Protection Act establishes a fiduciary duty to customers for financial intermediaries that provide advice.

The measure harmonizes the standard for broker-dealers by imputing the standard of conduct required for investment advisers under the Investment Advisers Act of 1940 when providing personalized investment advice about securities to a retail customer. The legislation also clarifies that the receipt of compensation based on commission or other standard compensation for the sale of securities shall not, in and of itself, be considered a violation of the fiduciary duty owed by a broker or dealer.

8. Regulation of Derivatives

The legislation blends the proposals offered by the House Financial Services Committee and the House Agriculture Committee. However, at the time of this writing, there remain a few issues not yet completely resolved between the two committees, including the so-called “Lynch Amendment” which would limit the amount of ownership certain Wall Street firms can have in a clearinghouse, swap execution facility (“SEF”) or other critical infrastructure of the derivatives markets. It would require the clearing of all swaps and security-based swaps accepted by a registered derivatives clearing organization or clearing agency. A registered clearing agency or derivatives clearing organization must submit to the CFTC or SEC for prior approval each swap, or any type of swaps that it seeks to accept for clearing. It would further require that all “functionally or economically similar” swaps and “fungible” security-based swaps shall be treated similarly. In the instance that the SEC and CFTC are unable to agree upon what should be cleared (or any other joint issue requiring both agencies’ agreement), the Treasury Department is designated to resolve any disputes.

With respect to reporting of transactions, cleared trades would mandatorily be reported by the derivatives clearing organization or clearing agency to the CFTC or SEC and also any swap repository designated by the CFTC or SEC. Non-cleared transactions must be reported either to a registered swap repository or to the CFTC or SEC. Registered swap repositories must provide data to the regulatory agencies to minimize systemic risk, and also provide certain aggregate information to the public.

Swaps would be required, with limited exception, to be executed through a board of trade designated as a contract market or a registered SEF. This legislation would define a SEF broadly as “an entity that facilitates the execution of swaps between two persons through any means of interstate commerce but which is not a designated contract market.” It further would require registration with the CFTC or SEC even if an SEF is already registered with and subject to the supervision of the other agency (though it may seek an exemption from registration). The legislation would require each SEF to comply with a list of core principles, which include monitoring trading for market manipulation, obtain and provide information to regulators, publish price, volume and other trading data and prohibiting trades in swaps readily susceptible to manipulation. Notably, it would not include adopting position limits, as proposed in the House Agriculture Committee’s version and Senator Dodd’s proposal.

Additionally, the legislation would permit the CFTC and SEC to adopt rules and regulations requiring registration of a foreign board of trade that provides the members located in the United States direct access to the electronic trading and order matching system of the foreign board of trade. The legislation would include an exemption to this requirement for any foreign board of trade granted direct access by the CFTC or SEC prior to enactment of this legislation.

For each of the primary market participants (SEFs, clearing agencies, swap repositories, swap dealers or swap participants), the SEC or CFTC would be able to exempt the participant from registration, if it finds that the entity is subject to comparable and comprehensive supervision and regulation on a consolidated basis by appropriate governmental authorities in the organization’s home country.

9. Regulation of Investment Advisers

The legislation is unrelated to other proposed legislative initiatives of the same name that have been introduced in recent months by various members of Congress and by the Obama administration.¹

Limitations on Certain Exemptions. The Private Fund Investment Advisers Registration Act of 2009 (“Private Fund Registration Act”) would eliminate the private fund adviser exemption contained in Section 203(b) of the Investment Advisers Act of 1940 (“Advisers Act”). As such, an exemption from registration would no longer be available to an investment adviser of a “private fund,” which the Private Fund Registration Act defines as a fund that would be an “investment company” under the Investment Company Act of 1940 (“Company Act”), but for the exceptions to that definition under Sections 3(c)(1) and 3(c)(7) of the Company Act. This definition would include all such funds wherever organized or located, unlike the definition for “private fund” contained in the Senate’s version of the Private Fund Registration Act, which was limited to funds organized in the U.S. or which are at least 10%-owned by U.S. persons. The Private Fund Registration Act would leave in place the foreign private fund adviser exemption already contained in the Advisers Act, but would define the term “foreign private fund adviser” as an investment adviser (1) with no place business in the U.S.; (2) during the preceding 12 months, has had fewer than 15 clients in the U.S. and assets under management attributable to U.S. clients of less than \$25 million; and (3) does not hold itself out to the public as an investment adviser, nor acts as an investment adviser to a registered investment company or a business development company. This modification of the foreign private fund adviser exemption closely resembles the modifications contained in the other legislative proposals.

Unlike the other legislative proposals, the Private Fund Registration Act would exempt from registration any investment adviser to licensed small business investment companies, entities that have received from the Small Business Administration a notice to proceed to qualify for a license, or applicants related to licensed small business investment companies which have license applications pending.

Collection of Systemic Risk Data. The Private Fund Registration Act contains provisions for the collection of certain types of data from investment advisers and their managed funds, mirroring the terms included in the initial draft offered by Rep. Paul Kanjorski (D-PA) (“Kanjorski Bill”). In particular, the SEC would be authorized to require any registered investment adviser to maintain records of and file with the SEC reports regarding the private funds they manage, which

¹ Recent unrelated legislative proposals of the same name include: the “Private Fund Investment Advisers Registration Act of 2009” (Treasury Bill) introduced by the Obama administration on July 15, 2009; the “Private Fund Investment Advisers Registration Act of 2009” (Kanjorski Bill) introduced by Representative Paul E. Kanjorski (D-PA), chairman of the House Financial Services Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises, issued in discussion draft on October 1, 2009, and thereafter introduced as H.R. 3818 on October 15, 2009; and the “Private Fund Investment Advisers Registration Act of 2009” included in Title IV of the “Restoring American Financial Stability Act of 2009” introduced by Senator Christopher Dodd (D-CT), Chairman of the Senate Banking Committee.

the SEC may disclose to the Board of Governors of the Federal Reserve and to any other entity with systemic risk responsibility. Information to be disclosed with respect of private funds would specifically cover: amount of assets under management, use of leverage, counterparty credit risk exposures, trading and investment positions, trading practices, and such other information as deemed appropriate. The SEC would also be authorized to set different reporting requirements for different classes of private fund advisers based on the types and sizes of funds advised.

The Private Fund Registration Act would eliminate Section 210(c) of the Advisers Act, which in its current form severely limits the SEC's ability to require an investment adviser to disclose the identity, investments or affairs of its clients.

Exemption for Venture Capital Fund Advisers. The Private Fund Registration Act contains substantially the same registration exemption for advisers to venture capital funds as contained in the Kanjorski Bill. Specifically, the SEC would be tasked with defining the term "venture capital fund," and although advisers to venture capital funds would be exempt from registration, the SEC would require such advisers to maintain records and provide annual or other reports as the SEC deems necessary. While the Senate's version of the Private Fund Registration Act also has an exemption from registration for venture capital fund advisers, it does not impose any record and reporting requirements on such advisers.

Exemption for Certain Private Fund Advisers. The Private Fund Registration Act also contains a registration exemption for advisers to private funds, so long as each private fund managed by an adviser has less than \$150 million of assets under management. Notwithstanding this registration exemption, such private advisers would still be required to maintain records and provide annual and other reports to the SEC as it deems necessary. This is in slight contrast to the Senate's version of the Private Fund Registration Act, which contains a registration exemption for advisers to "private equity funds," which the SEC would be required to define under that Act. In addition, the Private Fund Registration Act contains a provision under which the SEC would be obligated to prescribe regulations for the registration and examination of advisers to "mid-sized" private funds taking into account the size, governance and investment strategy of such funds. No definition is provided for the term "mid-sized" nor is it clear that "mid-sized" has a relation to the \$150 million threshold discussed above.

Additionally, The Private Fund Registration Act would clarify the SEC's rulemaking authority in much the same way proposed in the Kanjorski Bill. As such, the SEC would be permitted to issue, amend and rescind rules and regulations defining technical, trade and other terms used in the Private Fund Registration Act. In particular, the SEC may classify investment advisers and funds based upon their size, scope, business model, compensation scheme or potential to create or increase systemic risk. And in doing so, the SEC may prescribe different requirements for different classes of such advisers and funds and generally ascribe different meanings to terms used in different sections of the Private Fund Registration Act.

Comptroller General Study. The Comptroller General of the U.S. would be directed to perform a study to assess the annual costs on industry members and their investors due to registration requirements and ongoing reporting requirements, and to submit a report to Congress no later than the second anniversary of the date of the Private Fund Registration Act's enactment.

This provision of the Private Fund Registration Act is different than the “study” provision contained in the Senate’s version of the Private Fund Registration Act, which enumerates three other kinds of studies.²

The Private Fund Registration Act would go into effect on the one-year anniversary of its enactment, although investment advisers may register with the SEC prior to such date pursuant to rules and regulations prescribed by the SEC. Finally, the Private Fund Registration Act proposes that the SEC periodically determine new dollar amount thresholds used as factors in determining a person’s financial sophistication, experience and knowledge as may be required to enter into a contract with an investment adviser. The SEC would have to make its first determination, based on the effects of inflation, no later than one year following the enactment of the Private Fund Registration Act, and thereafter, every five years.

Annual Assessments. Under Section 7302, the SEC would be directed to establish rules to collect fees from registered investment advisers to help recover the cost of inspections and examinations of such registered advisers. Such fees would be payable upon registration and during each fiscal year thereafter in an amount that is “fair and reasonable” as determined by the SEC, which shall consider the following factors: the investment adviser’s size; the number of clients of the investment adviser; the types of clients of the investment adviser; and such other relevant factors as the SEC deems appropriate. The aggregate fees that would be determined by the SEC are required to be greater than the amount the SEC spent on inspections and examinations of registered investment advisers during the 2009 fiscal year. Fee rates would be reviewable by the SEC and adjustments could be before the end of a fiscal year. Penalties for late payment of fees could also be assessed by the SEC.

10. Executive Compensation

The legislation includes provisions requiring shareholder vote and disclosure upon the occurrence of certain events, independent compensation committees, and disclosure of incentive-based compensation.

“Say on Pay” Shareholder Vote. The legislation requires nonbinding shareholder vote on executive compensation upon the occurrence of certain events (such as a transaction that effects a change in control of the employer or proxies solicited in respect of any security registered under Section 12), as well as a nonbinding vote on golden parachute arrangements. Also, institutional investment managers must disclose their votes on executive compensation and golden parachute packages.

Independent Compensation Committee. In order to list securities on national exchanges, an issuer must ensure all members of its compensation committee of the board of directors are

² The Private Fund Registration Act calls for studies to be conducted on: (i) the appropriate criteria for determining “accredited investor” status and eligibility to invest in hedge funds; (ii) the feasibility of forming a self-regulatory body to oversee hedge funds, private equity funds and venture capital funds; and (iii) the state of short selling in the stock market, including the impact of recent short sale rule changes and the incidence of failure to deliver short sold shares.

independent (e.g., not paid any compensatory fee by the issuer). In addition, any compensation consultants or other advisors to the committee must be independent. The SEC will review the use of compensation consultants by issuers and report to Congress on their findings within 2 years.

Perverse Incentives. In the next nine months, regulations would be promulgated to require disclosure of all incentive-based compensation offered by all covered financial institutions (though there will be no identification of the actual persons who receive compensation). Financial institutions subject to these rules are broadly defined to include depository institutions, broker-dealers, credit unions, investment advisers, or any other financial institution deemed includible by certain regulatory agencies. Any financial institution with less than \$1 billion in assets will not be subject to these rules. In addition, the Government Accountability Office (“GAO”) will study whether there is a connection between compensation and excessive risk taking. The GAO will take into account compensation structures from 2000 to 2008 as well as comparisons between companies that failed and those that remained viable throughout the 2007 and 2008 financial crisis.