Financial Reform in the United States

Note: This Power Point presentation was prepared by the OECD Secretariat and corresponds to the transcript of the presentation by Mr. Sherman Boone, Assistant Director, Office of International Affairs, Securities and Exchange Commission

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Disclaimer: Before I begin my remarks, please let me remind you that they represent my own views, and not necessarily those of the Commission, the Commissioners, or other members of the staff.

- On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The Dodd-Frank Act provides for sweeping financial regulatory reform in the areas of banking, securities and insurance.

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HIGHLIGHTS OF THE LEGISLATION

- **The Dodd-Frank Act Expands the Perimeter of Regulation:** by eliminating loopholes in the regulation of over-the-counter derivatives, hedge funds, and mortgage brokers.
- **Addresses Systemic Risk:** by creating a council to identify and address systemic risks posed by large, complex companies, products, and activities before they threaten the stability of the economy.
- **Ends Too Big to Fail Bailouts:** by creating a safe way to liquidate failed financial firms; imposing tough new capital and leverage requirements that make it undesirable to get too big; updates the Fed's authority to allow system-wide support but no longer prop-up individual firms.

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HIGHLIGHTS OF THE LEGISLATION

- **Credit Rating Agencies:** by setting new rules for transparency and accountability of credit rating agencies.
- **Corporate Governance:** by providing shareholders with a "say on pay" and corporate affairs with a non-binding vote on executive compensation and golden parachutes.
- **Enforcement:** by strengthening oversight and empowers regulators to pursue financial fraud, conflicts of interest and manipulation of the system that benefits special interests. The Dodd-Frank Act also creates a whistleblower fund to encourage individuals to report securities law violations.

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EXTENDING THE PERIMETER OF REGULATION: OTC DERIVATIVES MARKET

- **The Dodd-Frank Act Closes Regulatory Gaps:** by providing the SEC and CFTC with authority to regulate over-the-counter derivatives; however, prudential regulators also have role in setting capital and margin for banks.
- **Regulating Swap Participants:** by creating a new regulatory scheme for the oversight and supervision of swap dealers and major swap participants.
- **Central Clearing and Exchange Trading:** by requiring central clearing and exchange trading for derivatives that can be cleared and providing a role for both regulators and clearing houses to determine which contracts should be cleared.

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EXTENDING THE PERIMETER OF REGULATION: OTC DERIVATIVES MARKET

- **Market Transparency:** by requiring data collection and publication through clearing houses or swap repositories to improve market transparency and providing regulators important tools for monitoring and responding to risks.
- **Regulates Foreign Exchange Transactions:** Foreign exchange swaps will be regulated like all other Wall Street contracts.
- **Increases Enforcement Authority**: by giving regulators broad enforcement authority to punish bad actors that knowingly help clients defraud third parties or the public.
- **Higher standard of conduct:** by establishing a code of conduct for all registered swap dealers and major swap participants when advising a swap entity.

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- **The Dodd-Frank Act Fills Regulatory Gaps:** by requiring hedge funds and private equity advisors to register with the SEC as investment advisers and provide information about their trades and portfolios necessary to assess systemic risk. This data will be shared with the systemic risk regulator and the SEC will report to Congress annually on how it uses this data to protect investors and market integrity.
- **New Recordkeeping Requirements:** by subjecting newly-registered investment advisers to recordkeeping, inspection by the SEC staff, and various other requirements relating to, *inter alia*, custody of client assets, compliance programs, the delivery of a specified disclosure document, *etc.*
- **Greater Supervision by the States:** Raises the assets threshold for federal regulation of investment advisers from $30 million to $100 million, a move expected to significantly increase the number of advisors under state supervision.

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ADDRESSING SYSTEMIC RISKS

- **The Dodd-Frank Act Sets up a Financial Stability Oversight Council:** which is charged with identifying and responding to emerging risks throughout the financial system. The Council will be chaired by the Treasury Secretary and include the Federal Reserve Board, SEC, CFTC, OCC, FDIC, FHFA, NCUA and the new Consumer Financial Protection Bureau.
- **The FSOC Regulates Nonbank Financial Companies:** by being authorized to require, with a 2/3 vote, that a nonbank financial company be regulated by the Federal Reserve if the council believe there would be negative effects on the financial system if the company failed or its activities would pose a risk to the financial stability of the US.

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ADDRESSING SYSTEMIC RISKS

- **The FSOC is Able to Break Up Large, Complex Companies:** by approving, with a 2/3 vote, a Federal Reserve decision to require a large, complex company, to divest some of its holdings if it poses a grave threat to the financial stability of the United States – but only as a last resort.
- **Makes Risks Transparent:** Through the Treasury's Office of Financial Research (OFR) and member agencies, the Council will collect and analyze data to identify and monitor emerging risks to the economy and make this information public in periodic reports and testimony to Congress every year.

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LIMITING LARGE, COMPLEX FINANCIAL COMPANIES AND PREVENTING FUTURE BAILOUTS

- **The Dodd-Frank Act Ends Taxpayer Funded Bailouts:** by clearly stating that taxpayers will not be on the hook to save a failing financial company or to cover the cost of its liquidation.
- **The FSOC Discourages Excessive Growth & Complexity:** by monitoring systemic risk and making recommendations to the Federal Reserve for increasingly strict rules for capital, leverage, liquidity, risk management and other requirements as companies grow in size and complexity, with significant requirements on companies that pose risks to the financial system.

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LIMITING LARGE, COMPLEX FINANCIAL COMPANIES AND PREVENTING FUTURE BAILOUTS

- **The Volcker Rule: r**equires regulators to implement regulations for banks, their affiliates and holding companies, to prohibit proprietary trading, investment in and sponsorship of hedge funds and private equity funds, and to limit relationships with hedge funds and private equity funds. Nonbank financial institutions supervised by the Fed will also have restrictions on proprietary trading and hedge fund and private equity investments.

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LIMITING LARGE, COMPLEX FINANCIAL COMPANIES AND PREVENTING FUTURE BAILOUTS

- **The FSOC Extends Regulation:** by having the ability to require nonbank financial companies that pose a risk to the financial stability of the United States to submit to supervision by the Federal Reserve.
- **The Dodd-Frank Act provides for payment, clearing, and settlement regulation.** Through a specific framework for promoting uniform risk-management standards for systemically important financial market utilities and systemically important payment, clearing, and settlement activities.

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LIMITING LARGE, COMPLEX FINANCIAL COMPANIES AND PREVENTING FUTURE BAILOUTS

- **Living Wills**: Requires large, complex financial companies to periodically submit plans for their rapid and orderly shutdown should the company go under. Companies will be hit with higher capital requirements and restrictions on growth and activity, as well as divestment, if they fail to submit acceptable plans.
- **Liquidation:** Creates an orderly liquidation mechanism for FDIC to unwind failing systemically significant financial companies. Shareholders and unsecured creditors will bear losses and management and culpable directors will be removed.

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CREDIT RATING AGENCIES

- **The Dodd-Frank Act Creates an Office of Credit Ratings at the SEC**: with expertise and its own compliance staff and the authority to fine agencies. The SEC is required to examine Nationally Recognized Statistical Ratings Organizations (NRSROs) at least once a year and make key findings public.
- **Disclosure:** Requires Nationally Recognized Statistical Ratings Organizations to disclose their methodologies, their use of third parties for due diligence efforts, and their ratings track record.

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CREDIT RATING AGENCIES

- **Independent Information:** Requires agencies to consider information in their ratings that comes to their attention from a source other than the organizations being rated if they find it credible.
- **Liability:** Investors can bring private rights of action against ratings agencies for a knowing or reckless failure to conduct a reasonable investigation of the facts or to obtain analysis from an independent source.
- **Eliminates Many Statutory and Regulatory Requirements to Use NRSRO Ratings:** and reduces over-reliance on ratings and encourages investors to conduct their own analysis.

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CORPORATE GOVERNANCE

- **The Dodd-Frank Act Provides for a Vote on Executive Pay and Golden Parachutes:** by giving shareholders a "say on pay" with the right to a non-binding vote on executive pay and golden parachutes.
- **Requires Independent Compensation Committees:** Standards for listing on an exchange will require that compensation committees include only independent directors and have authority to hire compensation consultants in order to strengthen their independence from the executives they are rewarding or punishing.

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CORPORATE GOVERNANCE

- **Enhanced Compensation Oversight for Financial Industry:** Requires federal financial regulators to issue and enforce joint compensation rules specifically applicable to financial institutions with a Federal regulator.

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