

The National LGBT Bar Association
 An Affiliate of the American Bar Association

Financial Regulation and Reform Working Group

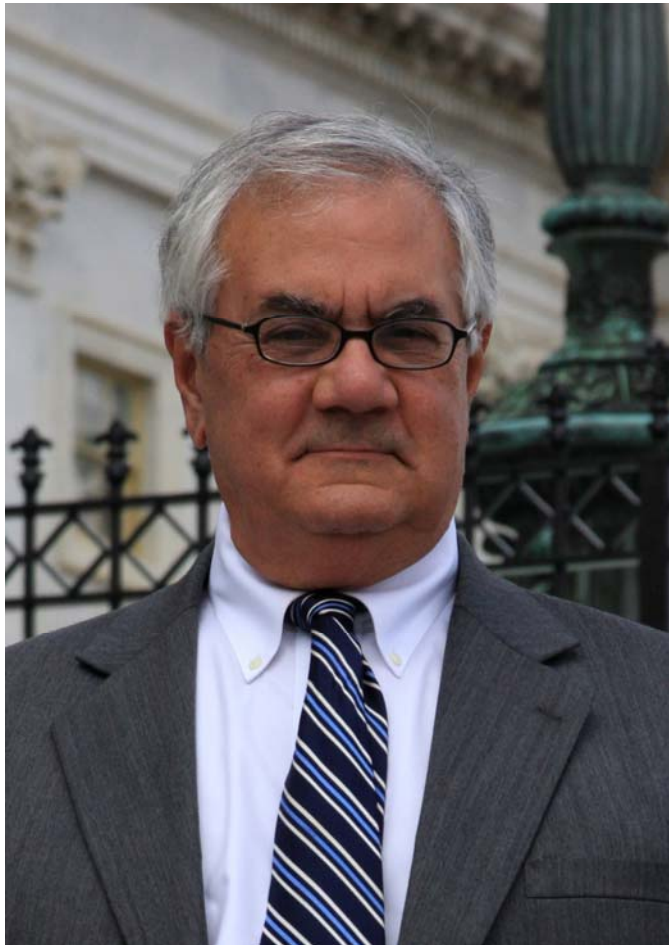
Presents

***Current Developments in the Implementation of the
Wall Street Reform and Consumer Protection Act: Views
from Capitol Hill and the SEC***

April 26, 2011

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- Introductions
 - Remarks from Congressman Frank
 - Q&A, Rep. Frank
 - Remarks from other panelists
 - Q&A
 - Closing Remarks

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- **Congressman Barney Frank**, Ranking Member, House Financial Services Committee
 - **John Ramsey**, Deputy Director, SEC Division of Trading and Markets
 - **Brian V. Breheny**, Corporate Partner, Skadden, Arps, Slate, Meagher & Flom; former Deputy Director, SEC Division of Corporate Finance
 - **Brian M. Castro**, Chairman and founding member, National LGBT Bar Association Financial Regulation & Reform Working Group; former Senior Counsel, FINRA Department of Enforcement



**Congressman
Barney Frank**
Ranking Member,
House Financial Services
Committee

Q&A

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mute function is turned off to allow your signal to
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Current Developments in the Implementation of the Wall Street Reform and Consumer Protection Act

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Title VII— Regulation of the Swaps Markets

April 26, 2011

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Background

- ❑ In 2000, Congress passed the Commodity Futures Modernization Act (“CFMA”) to provide legal certainty for OTC swap agreements.
- ❑ The CFMA prohibited the SEC from regulating the OTC swaps markets, but provided the SEC with antifraud authority over “security-based swap agreements,” such as credit default swaps.
- ❑ However, the SEC was specifically prohibited from imposing reporting, recordkeeping, or disclosure requirements or other prophylactic measures designed to prevent fraud with respect to security-based swap agreements.
- ❑ The CFMA similarly precluded the CFTC from regulating the OTC swaps markets.

Title VII of the Dodd-Frank Act

- Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”) addresses this gap in U.S. financial regulation by providing a comprehensive framework for the regulation of the swaps markets.
- Title VII has four broad policy objectives:
 - (1) preventing activities in the OTC derivatives markets from posing risk to the financial system;
 - (2) promoting efficiency and transparency of those markets;
 - (3) preventing market manipulation, fraud, and other market abuses; and
 - (4) ensuring that OTC derivatives are not marketed inappropriately to unsophisticated parties.

Jurisdictional Divide

- ☐ Swaps
- ☐ Security-Based Swaps
- ☐ Security-Based Swap Agreements
- ☐ Mixed Swaps

Security-Based Swaps

- The SEC has regulatory authority over “security-based swaps,” which are defined as swaps based on:
 - a single security or loan (including any interest therein or the value thereof);
 - a narrow-based security index (including any interest therein or the value thereof); or
 - events relating to a single issuer or issuers of securities in a narrow-based security index (such as credit default swaps). (DFA 761(a)(6), Exch. Act 3(a)(68))
- Note: The term “index” means an index or group of securities, including any interest therein or based on the value thereof. (DFA 761(a)(6); Exch. Act 3(a)(68)(E))
- Security-based swaps are included within the definition of security under the Exchange Act and Securities Act. (DFA 761(a)(2); Exch. Act 3(a)(10))

Major Areas of the Legislation

- ☐ Mandatory Central Clearing
- ☐ Mandatory Exchange Trading
- ☐ Market Participants
 - Swap and Security-Based Swap Dealers
 - Major Swap and Security-Based Swap Participants
- ☐ Trade Data Repositories
- ☐ Public Reporting

Mandatory Central Clearing

- ❑ In general, a security-based swap that is required to be cleared must submit the swap to a registered clearing agency or one that is exempt from registration. (DFA 763(a); Exch. Act 3C(a)(1))
- ❑ In determining whether a security-based swap is required to be cleared, the SEC must take into account, among other things:
 - Outstanding notional amount, trading liquidity, and adequate pricing data;
 - Rule framework, capacity, operational expertise, and other factors;
 - Effect on the mitigation of systemic risk;
 - Effect on competition; and
 - Existence of reasonable legal certainty with respect to customer property in the event of insolvency. (DFA 763(b); Exch. Act 3C(b)(4)(B))
- ❑ Exception to mandatory clearing: An entity that is not a financial entity and that uses security-based swaps to hedge or mitigate commercial risk and notifies the Commission how it generally meets its financial obligation associated with entering into non-cleared security-based swaps is exempted from the mandatory clearing requirement. (DFA 763(a); Exch. Act 3C(g)(1))

Mandatory Exchange Trading

- All security-based swaps that are required to be cleared must be traded on an exchange or a swap execution facility (“SEF”), unless no exchange or SEF will accept the swap for trading. (DFA 763(a); Exch. Act 3C(h)(1))
 - A “swap execution facility” is a new regulatory category subject to registration and other regulatory requirements. (DFA 763(c))
 - A swap execution facility is defined as a trading system or platform in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility. (DFA 761(a)(6); Exch. Act 3A(77))
- Because commercial end users are exempt from the mandatory clearing requirement they are not subject to the mandatory exchange trading requirement. (DFA 763(a); Exch. Act 3C(g)), 3C(h)(1))
- Retail Swaps. Security-based swaps with non-eligible contract participants must be traded on an exchange (not on a SEF) and must be registered under the 33 Act. (DFA 763(e); Exch. Act 6(l))

Regulation of Market Participants— Security-Based Swap Dealers

- A “security-based swap dealer” means any person who:
 - holds itself out as a dealer in security-based swaps;
 - makes a market in security-based swaps;
 - regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account; or
 - engages in any activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps. (DFA 761(a)(6); Exch. Act 3(a)(71))

Regulation of Market Participants— Major Security-Based Swap Participants

- A “major security-based swap participant” means a non-dealer:
 - who maintains a substantial position in security-based swaps for any of the major security-based swap categories, excluding positions held for hedging or mitigating commercial risk;
 - whose outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or
 - that is a financial entity that is highly leveraged relative to the amount of capital that such entity holds and maintains a substantial position of outstanding security-based swaps. (DFA 761(a); Exch. Act 3(a)(67))

Note: This regulatory category could capture entities like AIG, which might not fall within the definition of “swap dealer” or “security-based swap dealer,” because they are only one side of the market (in the case of AIG, as a writer of protection in the CDS market).

Substantive Regulation of Security-Based Swap Dealers and Major Security-Based Swap Participants

- Security-based swap dealers and major security-based swap participants are subject to numerous requirements under the Dodd-Frank Act.
 - Registration requirements (DFA 764(a); Exch. Act 15F(a))
 - Recordkeeping and reporting requirements (DFA 764(a); Exch. Act 15F(f), 15F(g))
 - Capital and initial and variation margin requirements adequate to ensure the safety and soundness of the institution (DFA 764(a); Exch. Act 15F(e))
 - Requirement to segregate margin (DFA 763(d); Exch. Act 3E(f))
 - General business conduct standards (DFA 764(a); Exch. Act 15F(h))
- Special Entities. The Dodd-Frank Act imposes more stringent business conduct requirements for dealings with “special entities.” (DFA 764(a); Exch. Act 15F(h)(5))

Security-Based Swap Data Repositories

- ❑ Security-based swap data repositories are a new regulatory category subject to SEC registration and other regulatory requirements. (DFA 763(i); Exch. Act 13(n)(1))
- ❑ Dodd-Frank states that the Commission shall prescribe standards that specify the data elements for each security-based swap that shall be collected and maintained by each registered security-based swap data repository. (DFA 763(i); Exch. Act 13(n)(4)(A))
- ❑ Clearing agencies may become security-based swap data repositories. (DFA 763(i); Exch. Act 13(m)(1)(H))

Public Reporting

- ❑ The CFTC and SEC are authorized to require “real-time public reporting” of information, including price and volume. (DFA 727; CEA 2A(13)(c)) (DFA 763(i), Exch. Act 13(m)(1))
- ❑ The term “real-time public reporting” means reporting data relating to a security-based swap transaction, including price and volume, as soon as technologically practicable after the time at which the security-based swap transaction has been executed. (DFA 763(i); Exch. Act 13(m)(1)(A))

International Consultations

- The SEC, CFTC, and prudential regulators are required to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to products and entities in this area. (DFA 752)
- The goal is to prevent regulatory arbitrage.
 - The swaps markets are very international – multiple places exist where business can be conducted (New York, London, Singapore, etc.)

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Status of Dodd-Frank Corporate Governance & Disclosure Rulemaking

December 2010

- Specialized Disclosure – Proposed
 - Rules regarding disclosure related to “conflict minerals”
 - Rules regarding disclosure of mine safety information
 - Rules for Public Comment regarding disclosure by resource extraction issuers

January 2011

- Say-on-Pay Rules – Adopted

March 2011

- Compensation Committees & Consultants – Proposed
 - Exchange listing standards regarding compensation committee independence and factors affecting compensation adviser independence
 - Disclosure rules regarding compensation consultant conflicts

April 2011

- Disclosure of Voting by Institutional Investment Managers Rules – Adopted

*Status of
Dodd-Frank Corporate Governance &
Disclosure Rulemaking (cont'd)*

August – December 2011

- Compensation Committees & Consultants
 - Adopting listing standards and SEC rules
- Specialized Disclosure
 - Adopt rules regarding disclosure related to “conflict minerals,” mine safety information and resource extraction issuers
- Executive Compensation
 - Propose rules regarding disclosure of pay-for-performance, pay ratios, and hedging by employees and directors
 - Propose rules regarding listing standards related to recovery of “erroneously awarded” executive compensation

Not Scheduled

- Broker voting
 - Propose rules defining “other significant matters” for purposes of exchange standards regarding broker voting of uninstructed shares

Annual Meeting Say-on-Pay

- At a company's first annual meeting taking place on or after January 21, 2011, shareholders will have two separate, non-binding votes:
 - “Say-on-pay”: a vote to approve the compensation of executive officers as disclosed in the proxy statement
 - “Frequency”: a vote on whether future say-on-pay votes should occur every one, two or three years
 - Frequency vote is required at least once every six years
- Although non-binding, a “no” vote is likely to have future consequences if underlying concerns are not addressed

Merger-Related Say-on-Pay

- SEC rules apply to proxy statements and other transaction-related SEC filings initially filed on or after April 25, 2011
- When shareholders are voting on a merger or similar transaction, companies must:
 - Include proxy disclosure describing agreements or understandings concerning compensation of any NEO based on or related to the transaction
 - Provide shareholders a separate non-binding vote to approve those merger-related compensation agreements or understandings
 - Vote is not required if the merger-related agreements or understandings previously were the subject of a required say-on-pay vote

Say-on-Pay: 2011 Experience

- Say-on-Frequency recommendations (estimated): 51.4% annual; 42.3% triennial; 3.4% biennial; and 2.9% none
- Companies reporting say-on-pay vote failures: 6
- 87.72% of triennial recommendations not approved

Dodd-Frank: Clawback Policies

- Requires listed companies to implement a policy to recoup executive compensation in the event of a restatement:
 - Restatement due to material noncompliance with any financial reporting requirement under the securities laws
 - Applies to all current and former executive officers who received incentive-based compensation (including stock options) during the three years preceding the restatement
 - Recoup difference between incentive-based compensation paid on the basis of erroneous data and amount of incentive-based compensation that would have been paid based on the corrected data

Dodd-Frank: Additional Executive Compensation Disclosures

- Pay versus performance:
 - Annual meeting proxy disclosure comparing executive compensation and the company's financial performance, taking into account changes in the value of the company's shares and dividends paid
- Internal pay ratio:
 - Median of the annual total compensation of all company employees other than the CEO;
 - Annual total compensation of CEO; and
 - Ratio of the two amounts

Conflict Minerals Disclosure

- Pursuant to the Dodd-Frank Act, SEC has proposed rules requiring disclosure as to whether certain minerals are used in the company's products and the source of those minerals
- As an initial matter, need to determine if any products contain these minerals:
 - columbite-tantalite (tantalum);
 - cassiterite (tin);
 - wolframite (tungsten); or
 - gold.

Proxy Access Provisions

- An alternative to a traditional proxy contest
 - Shareholders (meeting eligibility and procedural criteria) can have their director candidates included in the company's proxy statement and on a "universal" proxy card distributed by the company (Rule 14a-11)
 - Rules for "traditional" shareholder nominations and proxy contests are unchanged
- Rule 14a-8 was amended so that shareholders may submit proposals for additional proxy access

Current Status of Proxy Access: *On Hold*

- SEC granted a stay of Rules 14a-11 and the amendment to 14a-8 on October 4, 2010, pending resolution of Appellate Court review of the changes to the proxy and related rules
- Hearing held on April 7, 2011; decision possible by Summer 2011
- What should companies expect?

Q&A

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- To join the Working Group listserv, or to suggest topics for future programming, email FinancialRegulation@lgbtbar.org
 - To become a member of the Working Group, contact Brian Castro at BMC1@cornell.edu

Thank you for participating!