

Over the last year, Dodd-Frank Act implementation included introducing stronger supervision, risk management, stress testing, and disclosure standards; establishing resolution plans and an orderly liquidation regime for financial companies; regulating the derivatives markets to reduce risk and increase transparency; reforming the securitization markets; enhancing standards and disclosure requirements for hedge fund advisers; and implementing measures to enhance consumer and investor protection.

In addition, the Council has continued to make progress in fulfilling its mandate. It has issued a final rule and guidance relating to the designation of nonbank financial companies for Federal Reserve supervision and enhanced prudential standards, and has finalized the designation of an initial set of eight systemically important financial market utilities that will be subject to enhanced risk-management standards. The Council also continued to monitor potential risks to U.S. financial stability; fulfilled explicit statutory requirements, including the completion of three reports; and served as a forum for discussion and coordination among the member agencies implementing the Dodd-Frank Act.

The following is a discussion of the significant implementation progress the Council and its member agencies have achieved since the Council's previous annual report.

6.1 Safety and Soundness

6.1.1 Enhanced Prudential Standards and Dodd-Frank Act Stress Tests

Sections 165 and 166 of the Dodd-Frank Act require the Federal Reserve to establish enhanced prudential standards and early remediation requirements for certain large bank holding companies (BHCs) and for nonbank financial companies designated for Federal Reserve supervision. In December 2011, the Federal Reserve issued, for public comment, a proposal to implement the enhanced prudential standards and early remediation requirements. The Dodd-Frank Act requires the enhanced standards established by the Federal Reserve for covered companies under Section 165 to (1) be more stringent than those standards applicable to other BHCs and nonbank financial companies that do not present similar risks to U.S. financial stability and (2) increase in stringency based on the systemic footprint and risk characteristics of individual covered companies.

The Federal Reserve's proposal includes risk-based capital, leverage, liquidity, single-counterparty credit exposure limits, supervisory and company-run stress testing, risk management and a risk committee, and early remediation requirements. The proposal would generally apply to all U.S. BHCs with consolidated assets of \$50 billion or more and any nonbank financial company that is designated by the Council for supervision by the Federal Reserve. The requirements to establish a risk committee of the board of directors and to conduct a company-run stress test

would also apply to BHCs with total consolidated assets of \$10 billion or more. With the exception of the requirements related to company-run stress tests, savings and loan holding companies (SLHCs) that are not designated by the Council would not be subject to the requirements under this proposal. The Federal Reserve's proposal addresses the following:

Risk-based capital and leverage requirements. These rules would be implemented in two phases. In the first phase, the institutions would be subject to the Federal Reserve's capital plan rule, which was published in December 2011. That rule requires covered companies to develop annual capital plans, conduct stress tests, and maintain adequate capital, including a tier one common risk-based capital ratio greater than 5 percent, under both expected and stressed conditions. In the second phase, the Federal Reserve would issue a proposal to implement a risk-based capital surcharge based on the framework and methodology developed by the Basel Committee on Banking Supervision (BCBS).

Liquidity requirements. These measures would also be implemented in multiple phases. First, covered companies would be subject to qualitative liquidity risk-management standards generally based on the interagency liquidity risk-management guidance issued in March 2010. These standards would require covered companies to conduct internal liquidity stress tests and set internal quantitative limits to manage liquidity risk. In the second phase, the Federal Reserve would issue one or more proposals to implement quantitative liquidity requirements based on the Basel III liquidity requirements.

Stress tests. Stress tests of the covered companies would be conducted annually by the Federal Reserve using three economic and financial market scenarios. A summary of the results, including company-specific information, would be made public. In addition, the proposal would require covered companies to conduct one or more company-run stress tests each year and to make a summary of their results public.

Single-counterparty credit limits. These requirements would limit credit exposure of a covered financial company to a single counterparty as a percentage of the firm's regulatory capital. Credit exposure between the largest financial companies would be subject to a tighter limit.

Risk management requirements. The proposal would require covered companies to establish a stand-alone risk committee of the board of directors, and appoint a chief risk officer to oversee enterprise-wide risk management. BHCs with \$10 billion or more in consolidated assets would also be required to establish an independent risk committee of the board.

Early remediation requirements. These measures would be put in place for all firms subject to the proposal so that financial weaknesses are addressed at an early stage. The Federal Reserve has proposed a number of triggers for remediation—such as capital levels, stress test results, and risk-management weaknesses—in some cases calibrated to be forward-looking. Required actions would vary based

on the severity of the situation but could include restrictions on growth, capital distributions, and executive compensation, as well as capital raising or asset sales.

The Federal Reserve consulted with members of the Council in developing this proposal. The comment period for the proposal closed on April 30, 2012.

In addition to the stress-testing requirements to be conducted by the Federal Reserve, Section 165(i)(2) of the Dodd-Frank Act also requires certain financial institutions to conduct stress tests based on regulations issued by that institution's primary federal regulator. In January 2012, the OCC, Federal Reserve, and FDIC issued proposed rules to implement these stress test requirements for institutions where they are the primary federal regulator. The comment period on these rules closed in April 2012. The Federal Reserve, OCC, and FDIC are coordinating their respective rulemakings to implement these provisions.

6.1.2 Transfer of Office of Thrift Supervision Functions

Title III of the Dodd-Frank Act transferred various powers and functions of the former Office of Thrift Supervision (OTS) to the OCC, FDIC, and Federal Reserve. This transfer of functions occurred on July 21, 2011, with the Federal Reserve assuming responsibilities for SLHCs, the OCC assuming responsibilities for federal savings associations, and the FDIC for state savings associations. The OCC, FDIC, and Federal Reserve coordinated their efforts to help ensure a smooth transfer of these functions and affected OTS employees. To clarify which agency will be enforcing the OTS rules, the Dodd-Frank Act required the OCC, FDIC, and Federal Reserve to publish a notice in the Federal Register identifying those regulations of the OTS that the agencies will enforce. The FDIC and OCC issued a joint notice on July 6, 2011, and the Federal Reserve issued its notice on July 21, 2011. The OCC has taken a number of additional actions to incorporate applicable OTS regulations in the OCC's chapter of the Code of Federal Regulations and to integrate OTS and OCC regulations and supervisory guidance. The Federal Reserve has similarly taken several steps to establish regulations and supervisory guidance for SLHCs. On July 21, 2011, the Federal Reserve issued supervisory guidance discussing the Federal Reserve's transitional supervisory approach for SLHCs. The Federal Reserve also published an interim rule to incorporate SLHCs into the Federal Reserve's chapter of the Code of Federal Regulations and notices outlining the regulatory reporting requirements for SLHCs.

As of December 31, 2011, there were 417 top tier SLHCs with estimated total consolidated assets of approximately \$3 trillion. These SLHCs include approximately 48 companies engaged primarily in nonbanking activities, such as insurance underwriting (approximately 27 SLHCs), commercial activities (approximately 11 SLHCs), and securities brokerage (10 SLHCs).

The 25 largest SLHCs accounted for more than \$2.6 trillion of total consolidated assets. Of the SLHCs engaged primarily in depository activities, only five institutions were in the top 25, yet approximately 88 percent of the total SLHCs were engaged primarily in depository activities. The depository firms, however, held only 13 percent or \$388 billion of the total SLHC consolidated assets.

6.1.3 Capital Standards, Comprehensive Capital Analysis and Review, and Supervisory Guidance Regarding Stress-Testing Practices

In June 2012, the federal banking agencies invited comment on three joint proposed rules that would revise and replace the agencies' current capital rules. The proposals would implement, in the United States, certain aspects of Basel II and 2.5, the Basel III capital reforms, and the Dodd-Frank Act, and would address shortcomings in regulatory capital requirements that became apparent during the recent financial crisis. The first Basel III notice of proposed rulemaking (NPR) would apply to all insured banks and savings associations, top-tier BHCs domiciled in the United States with more than \$500 million in assets, and SLHCs that are domiciled in the United States. Provisions of this NPR that would apply to these banking organizations include implementation of a new common equity tier one minimum capital requirement, a higher minimum tier one capital requirement, and, for banking organizations subject to the advanced approaches capital rules, a supplementary leverage ratio that incorporates a broader set of exposures. Additionally, consistent with Basel III, the agencies propose to apply limits on a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a specified "buffer" of common equity tier one capital in addition to the minimum risk-based capital requirements. This NPR also would revise the agencies' prompt corrective action framework by incorporating the new regulatory capital minimums and introducing common equity tier one capital as a new regulatory capital component. Prompt corrective action is an enforcement framework that constrains the activities of an insured depository institution based on its level of regulatory capital.

In the second capital NPR, also known as the "standardized approach," the agencies propose to revise and harmonize rules for calculating risk-weighted assets to enhance risk sensitivity and address weaknesses identified over recent years, including by incorporating aspects of the Basel II standardized framework, and alternatives to credit ratings, consistent with Section 939A of the Dodd-Frank Act. The revisions include methods for determining risk-weighted assets for residential mortgages, securitization exposures, and counterparty credit risk. The NPR also would introduce disclosure requirements that would apply to U.S. banking organizations with \$50 billion or more in total assets. This NPR would apply to the same set of institutions as the first NPR.

The third Basel III NPR would revise the advanced approaches risk-based capital rules consistent with Basel III and other changes to the BCBS's capital standards. The agencies also propose revising the advanced approaches risk-based capital rules to be consistent with Section 939A and Section 171 of the Dodd-Frank Act. Additionally, in this NPR, the OCC and FDIC propose that the market risk capital rules apply to federal and state savings associations, and the Federal Reserve proposes that the advanced approaches and market risk capital rules apply to top-tier SLHCs domiciled in the United States if stated thresholds for trading activity are met. Generally, the advanced approaches rules would apply to such institutions with \$250 billion or more in consolidated assets or \$10 billion or more

in foreign exposure, and the market risk capital rule would apply to SLHCs with significant trading activity.

In March 2012, the Federal Reserve disclosed summary results of the 2012 Comprehensive Capital Analysis and Review (CCAR). The CCAR is an exercise to evaluate the capital planning processes and capital adequacy of the largest BHCs. This exercise includes both company-run and supervisory stress tests to evaluate whether firms would have sufficient capital in times of severe economic and financial stress to continue to lend to households and businesses. The Federal Reserve estimated revenue and losses under the stress scenario based on detailed data provided by the firms and verified by supervisors. (See Section 5.2 for a more detailed discussion of the CCAR.)

As a part of the CCAR, the Federal Reserve evaluates institutions' capital plans across a range of criteria, including a stress test that examines whether a firm could make all the capital distributions included in its plan, such as dividends and stock repurchases, while still maintaining capital above the Federal Reserve's standards in a hypothetical supervisory stress scenario. Other considerations for capital distributions include an evaluation of the firms' capital planning processes and plans to meet the new Basel III requirements that are scheduled to be phased in beginning 2013, assuming the final adoption of the Basel III NPR.

Under the Federal Reserve's proposed stress-testing rules (noted in Section 6.1.1), the results of the company-run stress test would be incorporated into the analysis supporting a company's capital plan submission. The supervisory stress test would be conducted by the Federal Reserve during the annual capital plan review process and would be used as a tool to help the Federal Reserve assess the adequacy of the company's capital plan.

In April 2012, the Federal Reserve announced the formation of the Model Validation Council (MVC). The MVC will provide the Federal Reserve with expert and independent advice on its process to rigorously assess the models used in stress tests of banking institutions. The MVC is intended to improve the quality of the Federal Reserve's model assessment program and to strengthen the confidence in the integrity and independence of the program.

In May 2012, the Federal Reserve, OCC, and FDIC issued final supervisory guidance regarding stress-testing practices at banking organizations with total consolidated assets of more than \$10 billion. The guidance highlights the importance of stress testing at banking organizations as an ongoing risk-management practice that supports a banking organization's forward-looking assessment of its risks and better equips it to address a range of adverse outcomes. While the guidance does not implement the stress-testing requirements of the Dodd-Frank Act for certain large BHCs and nonbank financial companies designated for supervision by the Federal Reserve (see Section 6.1.1), the guidance is intended to provide entities subject to the Dodd-Frank Act or other stress-testing requirements with principles to follow

when conducting stress tests in accordance with the Dodd-Frank Act or other statutory or regulatory requirements.

6.1.4 Volcker Rule

Section 619 of the Dodd-Frank Act, commonly known as the Volcker Rule, generally prohibits banking entities from engaging in proprietary trading and from investing in or sponsoring hedge funds and private equity funds, subject to certain exceptions.

Section 619 requires implementation in several stages. First, the Council was required to conduct a study and make recommendations on implementing the Volcker Rule. The Council study, which was issued on January 18, 2011, recommended principles for implementing the Volcker Rule and suggested a comprehensive framework for identifying activities prohibited by the rule, including an internal compliance regime, quantitative analysis, reporting, and supervisory review. Second, the Federal Reserve was required to publish a rule to implement the conformance period during which banking entities, and nonbank financial companies supervised by the Federal Reserve, must bring their activities and investments into compliance with Section 619 of the Dodd-Frank Act. The Federal Reserve published a final conformance rule on February 14, 2011.

By statute, following completion of the Council's study, authority to adopt implementing regulations is divided among the Federal Reserve, FDIC, OCC, SEC, and CFTC. The statute requires the rulemaking agencies to consult and coordinate with each other, as appropriate, for the purposes of assuring, to the extent possible, that their rules are comparable and provide for consistent application and implementation. The Chairperson of the Council is responsible for coordination of the regulations. On October 11 and 12, 2011, four of the rulemaking agencies invited the public to comment on proposed rules implementing the Volcker Rule's prohibitions and requirements. The CFTC requested comment on a substantively identical proposal on January 11, 2012. The agencies received over 18,000 comments from the public on the proposal and are working to finalize their rules.

Pending issuance of final rules, the Federal Reserve issued a statement of policy on April 19, 2012, clarifying that entities subject to the Volcker Rule have the full two-year conformance period provided by statute, which would be until July 21, 2014, to conform their activities and investments to the requirements of the Volcker Rule and the final implementing rules. By statute, that deadline may be extended by the Federal Reserve. The Federal Reserve's statement of policy noted that banking entities should engage in good-faith planning efforts to enable them to comply with the Volcker Rule and final implementing rules by no later than the end of the statutory conformance period. The rulemaking agencies also announced that they plan to administer their oversight of banking entities under their respective jurisdictions in accordance with the Federal Reserve's conformance rule and statement of policy.

6.1.5 Resolution Plans and Orderly Liquidation Authority

Resolution Plans

Section 165(d) of the Dodd-Frank Act requires nonbank financial companies designated by the Council for supervision by the Federal Reserve and BHCs with total consolidated assets of \$50 billion or more (“covered companies”) to prepare and submit to the Federal Reserve, the FDIC, and the Council plans—sometimes referred to as “living wills”—for their rapid and orderly resolution under the U.S. Bankruptcy Code. The Federal Reserve and the FDIC must review each plan and may jointly determine that a resolution plan is not credible or would not facilitate an orderly resolution of the company under the U.S. Bankruptcy Code. Failure to resubmit a credible plan within the timeframe set by the Federal Reserve and FDIC may result in the agencies jointly imposing more stringent capital, leverage, or liquidity requirements, or restrictions on the growth, activities, or operations of the company, or any subsidiary thereof, until the company resubmits a plan that remedies the deficiencies. If the company has failed to resubmit an acceptable plan within two years after the imposition of more stringent requirements or restrictions, the Federal Reserve and FDIC, in consultation with the Council, may jointly require divestiture of certain assets or operations to facilitate an orderly resolution under the U.S. Bankruptcy Code in the event of the company’s failure.

In November 2011, the FDIC and the Federal Reserve published a joint final rule that implements the resolution plan requirement. In accordance with the joint final rule, covered companies with \$250 billion or more in total nonbank assets (or, in the case of a foreign-based covered company, \$250 billion or more in total U.S. nonbank assets) were required to submit their resolution plans to the Federal Reserve and the FDIC by July 1, 2012. Covered companies with at least \$100 billion (but less than \$250 billion) in total nonbank assets (or at least \$100 billion but less than \$250 billion in total U.S. nonbank assets, for a foreign-based covered company) must submit their initial plans by July 1, 2013. Covered companies with less than \$100 billion in total nonbank assets must submit their initial plans by December 31, 2013.

As a complement to this rulemaking, the FDIC issued a final rule requiring any FDIC-insured depository institution with assets of \$50 billion or more to develop, maintain, and periodically submit plans outlining how the FDIC would resolve it through the FDIC’s resolution powers under the Federal Deposit Insurance Act. These two rulemakings are designed to work in tandem by covering the full range of business lines, legal entities, and capital structure combinations within a large financial firm. Their overarching objective is to promote stability, but they should also improve contingency planning and risk management at a covered institution and improve the outcomes for an institution’s constituencies and stakeholders if the institution fails. Importantly, as covered companies prepare and submit their living wills and those plans are reviewed, the process is expected to result in an ongoing dialogue between the supervisors and the firms that allows for continual improvements as the plans develop.

Orderly Liquidation Authority

Title II of the Dodd-Frank Act establishes a new framework—the orderly liquidation authority (OLA)—to address the potential failure of a BHC or other financial company when the failure of the financial company¹ and its resolution under the bankruptcy code or otherwise applicable federal or state law would have serious adverse effects on financial stability in the United States. Under OLA, the FDIC would act as receiver of the financial company, and would resolve the company subject to OLA.²

In July 2011, the FDIC board approved a final rule implementing its Title II authority. The rulemaking, among other things, clarified the claims process and priorities for unsecured creditors as well as the treatment of secured creditors in a Title II resolution. In March 2012, the FDIC published a proposed rule setting forth the conditions and requirements that would govern the FDIC's exercise of its authority under the OLA to enforce certain contracts of subsidiaries or affiliates of a financial company notwithstanding contract clauses that purport to terminate, accelerate, or provide for other remedies based on the insolvency, financial condition, or receivership of the financial company. The comment period on the proposed rule closed on May 29, 2012. It is anticipated that a final rule will be issued in the near future.

Under Title II, the FDIC has the authority to borrow funds from the Treasury and to incur other obligations in connection with the orderly liquidation of a financial company, subject to a maximum obligation limitation (MOL). In June 2012, the FDIC and Treasury published, after notice and comment, a joint final rule governing the calculation of the MOL. Also, in April 2012, the FDIC adopted, after notice and comment, a final rule that sets forth the conditions under which a mutual insurance holding company would be treated as an insurance company for purposes of Title II. The FDIC also intends to propose additional rules to implement the OLA, including (1) rules governing the minimum right of recovery and (2) joint rules with the SEC, after consultation with the Securities Investor Protection Corporation, governing the orderly resolution of certain broker-dealers (BD).

Furthermore, Section 210 of the Dodd-Frank Act requires the FDIC “to coordinate, to the maximum extent possible” with appropriate foreign regulatory authorities in the event of a resolution of a covered company with cross-border operations. The FDIC has been working diligently on both multilateral and bilateral bases with foreign counterparts in supervision and resolution to address these crucial cross-border issues. Although U.S. firms have operations in many countries, those operations tend to be concentrated in a relatively small number of key jurisdictions, particularly, the UK. The FDIC and UK authorities have made substantial progress in identifying and overcoming impediments to resolution. To facilitate bilateral discussions and cooperation, the FDIC is negotiating memoranda of understanding with certain foreign counterparts that will provide a formal basis for information sharing and cooperation relating to resolution planning and implementation under the legal framework of the Dodd-Frank Act.

6.1.6 Removal of References to Credit Ratings

Section 939 of the Dodd-Frank Act removes references to credit ratings in certain statutes, while Section 939A requires each federal agency to review its regulations that require the use of an assessment of creditworthiness of a security or money market instrument and any references to or requirements in such regulations regarding credit ratings. Each agency must modify its regulations as identified by the review to remove references to or requirements of reliance on credit ratings and to substitute appropriate standards of creditworthiness.

As required by Section 939A, after enactment of the Dodd-Frank Act, federal agencies reported to Congress on the review of their regulations that use credit ratings and a description of any of the regulations. Numerous federal agencies have proposed or finalized rules that would modify their regulations to comply with the Section 939A requirements. For example, the federal banking regulators, in June 2012, finalized revisions to the market risk capital rules that implement alternatives to credit ratings for debt and securitization positions. Concurrently, the federal regulators invited public comment on three proposed rules to revise and replace the agencies' current capital rules, including implementing the changes required by Section 939A. The SEC adopted rule amendments removing credit ratings as conditions for companies seeking to use short-form registration when registering non-convertible securities for public sale and proposed several other rules that would remove credit rating agency references from many of its investment company rules and its rules applicable to BD financial responsibility, distributions of securities, and confirmations of transactions; the FDIC issued a final rule removing credit ratings from the calculation of deposit insurance risk-based assessments for large insured depository institutions; and the OCC issued a final rule to remove references to credit ratings in the OCC's rules for investments in securities, securities offerings and foreign bank capital equivalency deposit regulations. In December 2011, the FDIC proposed revisions to part 362 of the FDIC's regulations that would prohibit an insured savings association from acquiring and retaining any corporate debt security unless it determines, prior to acquiring such security and periodically thereafter, that the issuer has adequate capacity to meet all financial commitments under the security for the projected life of the investment. The FDIC's December 2011 NPR is consistent with the OCC's final rule noted above regarding permissible investments.

6.1.7 Insurance

Section 111 of the Dodd-Frank Act, which established the Council, also provides that one of the ten voting members, in addition to the nine named heads of federal agencies, shall be "an independent member appointed by the President, by and with the advice and consent of the Senate, having insurance expertise." On September 28, 2011, the President's appointee, referred to as the "independent member," was sworn in and seated as a member of the Council for a six-year term. Since that time, the independent member has established an office and has actively engaged in the work of the Council and its committees with the assistance of a staff of two employees with insurance expertise. The independent member has also actively consulted with state insurance regulators and Federal Reserve System staff responsible for the development and implementation of the supervisory framework for insurance companies.

The Federal Insurance Office (FIO) within the Treasury was established by the Dodd-Frank Act with the authority, among others, to monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the U.S. financial system. FIO is authorized to coordinate federal efforts and develop federal policy on prudential aspects of international insurance matters, including representing the United States, as appropriate, in the International Association of Insurance Supervisors (IAIS). In exercising its authorities, FIO consults with federal agencies, insurance regulators, and interested parties.

This past year, FIO joined the IAIS and its executive and other committees, all of which also include U.S. state insurance regulators as members. Through the IAIS, insurance regulators, supported by the National Association of Insurance Commissioners (NAIC), and FIO work with the insurance supervisors of other countries on international regulatory initiatives such as a common framework for regulating internationally active insurance groups. Through the IAIS, FIO and U.S. state insurance regulators are also working collaboratively with other insurance supervisors to develop a sound approach to the identification and oversight of global systemically important insurers.

In addition to its existing responsibility for supervision of a BHC that is a major life insurance company, on July 21, 2011, the Federal Reserve assumed responsibility for over 25 SLHCs that engage in significant volumes of life, property and casualty, or title insurance underwriting. The unique aspects of the insurance industry are addressed in various regulations that have been published for the BHC and SLHC populations. The Federal Reserve developed and implemented a specialized supervisory approach and customized supervisory guidance that reflects the risks and characteristics of the industry. This approach includes communication and coordination with state insurance regulators.

Insurance regulators, through the NAIC, continue work on updating the Insurance Financial Solvency Framework. Two of the more important initiatives relate to the continued work of the Solvency Modernization Initiative, which led to the adoption of the Own Risk and Solvency Assessment (ORSA) Guidance Manual in March 2012 and the revised Credit for Reinsurance Model Law in late 2011. Later this year, state regulators are expected to finalize the ORSA Model Law to establish the ORSA filing requirement and the Valuation Manual, which will allow states to consider adoption of the Standard Valuation Law to implement principles-based reserving.

6.2 Financial Infrastructure, Markets, and Oversight

6.2.1 Over-the-Counter Derivatives Reform

Title VII of the Dodd-Frank Act establishes a comprehensive regulatory framework for the over-the-counter (OTC) derivatives marketplace. The regulatory structure for derivatives set forth in the Dodd-Frank Act is intended to promote, among other things, exchange trading and centralized clearing of swaps and security-based swaps, as well as greater transparency in the derivatives markets and enhanced monitoring of the entities that use these markets.

The CFTC and SEC have proposed and begun to finalize numerous rules pursuant to the public notice and comment process and have engaged in extensive public outreach and interagency coordination, including public roundtables with agency staff, market participants, and other concerned members of the public; meetings involving staff from multiple regulators, both domestic and international; and agency staff meetings with members of the public.

The SEC and CFTC have jointly adopted rules further defining the terms “swap,” “security-based swap,” “security-based swap agreement,” and have also adopted final joint rules defining the terms “swap dealer,” “security-based swap dealer,” “major swap participant,” and “major security-based swap participant.”

In addition, the CFTC and the federal banking agencies issued proposed rules on capital and margin requirements for entities within their respective jurisdictions (for the CFTC, certain swap dealers and major swap participants; for the federal banking agencies, certain securities-based swap dealers and major swap participants as well). The proposed rules would impose initial margin and variation margin requirements for uncleared swaps held by entities under each agency’s jurisdiction. With respect to capital requirements, the federal banking agencies’ existing regulatory capital rules take into account and address the unique risks arising from derivatives transactions and would apply to transactions in swaps and security-based swaps. The CFTC has proposed capital requirements for entities under its jurisdiction.

The CFTC has adopted several final rules, including reporting requirements to swap data repositories for swap dealers, major swap participants, and swap counterparties; rules that establish the process by which the CFTC will review swaps to determine whether the swaps are required to be cleared; and business conduct standards and other regulatory requirements for swap dealers and major swap participants.

The SEC has proposed rules to implement corresponding requirements for security-based swaps, and has adopted final rules that establish the process by which the SEC will review security-based swaps to determine whether the security-based swaps are required to be cleared.

The SEC and the CFTC are considering the structural and systems changes market participants will have to make to satisfy the new derivatives regulatory framework. The agencies are also considering a phased-in approach to implementing the new rules. In June 2012, the SEC issued a policy statement describing the order in which it expects the rules regulating the security-based swap market to take effect. This ordering is intended to give security-based swap market participants adequate, but not excessive, time to come into compliance with the new rules applicable to them.

On an international level, U.S. regulators are working as part of a group composed of representatives of the BCBS, the Committee on the Global Financial System, the Committee on Payment and Settlement Systems, and the International Organization of Securities Commissions to develop international

standards for margin on non-centrally cleared derivatives. This group took an important first step when it issued a consultative report in July 2012.

6.2.2 Private Fund Adviser Registration and Oversight

Title IV of the Dodd-Frank Act closes a regulatory gap by making numerous changes to the registration, reporting, and recordkeeping requirements of the Investment Advisers Act of 1940 (Advisers Act). These provisions are designed to provide the SEC with oversight authority over previously unregistered investment advisers to certain types of private funds, including hedge funds and private equity funds, and the authority to require recordkeeping and reporting by advisers to venture capital funds.

Sections 404 and 406 of the Dodd-Frank Act authorize the SEC to collect data from investment advisers about their private funds to enable the Council to assess systemic risk and require a joint rulemaking of the SEC and CFTC for investment advisers that are registered with both the SEC and CFTC. The agencies implemented this provision in October 2011 by adopting a rule that requires certain advisers to hedge funds, private equity funds, and liquidity funds to report non-public data regarding their operations and the risk profiles of the private funds they manage. Under the rule, SEC-registered investment advisers with at least \$150 million in private fund assets under management must periodically file a new reporting form (Form PF). Private fund advisers that are also registered with the CFTC as commodity pool operators or commodity trading advisers may satisfy systemic risk reporting requirements of the CFTC by filing Form PF with the SEC. The first filings of Form PF, covering private fund advisers with \$5 billion or more in private fund assets, are due in July 2012 for liquidity fund advisers and in August 2012 for hedge fund advisers. Smaller liquidity fund and hedge fund advisers, as well as private equity fund advisers, will be required to begin filing Form PF for the period ending December 31, 2012.

In addition, in June 2011, the SEC adopted a rule that requires advisers to certain types of private funds, including hedge funds and private equity funds, to register with the SEC. To enhance the SEC's ability to oversee these advisers and enable the public to better assess the activities of private funds, the SEC requires private fund advisers to provide basic public information on Form ADV about the funds they manage, including information about the amount of assets held by the fund and identification of fund service providers (e.g., auditors, prime brokers, custodians, administrators, and marketers). In addition, the SEC requires all advisers to provide further information on Form ADV about an adviser's clients, employees, and advisory activities. Investment advisers that had previously relied on the Investment Advisers Act exemption for private advisers, which was eliminated by the Dodd-Frank Act, were required to register with the SEC by March 2012. Registered investment advisers are required to adopt and implement policies and procedures to prevent violation of the Advisers Act and SEC rules.

6.2.3 Office of Financial Research

The purposes of the Office of Financial Research (OFR) are to support the Council in fulfilling the Council's purposes and duties and to support the Council's member agencies. The OFR serves as a data and research resource for

the Council and its member agencies, and it is working with those agencies to mitigate reporting burdens and increase market transparency. In this context, the OFR serves as a shared resource for Council members and their agencies and staffs.

The OFR provides data and analysis to support that work, either as a participant in Council activities or in response to requests from Council members or their agencies or staffs. The OFR will have the capacity to provide in-depth, long-term research, as well as rapid analyses of significant financial events to inform the Council's policy discussions. The OFR also has a responsibility to evaluate and report on stress tests and other stability-related assessments of financial entities overseen by member agencies, provide advice to member agencies on the impact of their policies as they relate to financial stability, investigate disruptions and failures in the financial markets, and provide its analysis to the Council, Congress, and the public.

The OFR is working with Council member agencies to support an international initiative to establish a unique, global standard for identifying parties to financial transactions. This Legal Entity Identifier (LEI) will allow for a better understanding by both regulators and market participants of true exposures and counterparty risks across the system. In July, the OFR publishes its first annual report to Congress on its research and data-related work to assess risks to financial stability.

The Dodd-Frank Act provides that the OFR would be headed by a Director appointed by the President and confirmed by the U.S. Senate. In December 2011, President Obama nominated Richard B. Berner to serve as the first Director of the OFR. That nomination is pending before the Senate.

6.2.4 Market Structure

Over the past several years, the SEC has been considering a range of issues relating to developments in equity market structure. As a part of this process, the SEC issued a concept release in January 2010 to seek public comment on a wide range of market structure issues, including high-frequency trading, order routing, market data linkages, and undisplayed, or "dark," liquidity. The SEC continues to consider the issues raised in the 2010 concept release and whether additional regulatory actions are needed in this area.

Recently, the SEC has taken specific actions to address market structure issues. For example, in July 2012, the SEC adopted a rule that would require SROs to develop a plan to create a consolidated audit trail. Such a consolidated audit trail would improve the timeliness and breadth of the information available to regulators for surveillance, investigations, and analysis of equity market activity. In June 2012, the SEC approved two proposals submitted by the national securities exchanges and FINRA that are designed to address extraordinary volatility in individual securities in the broader U.S. stock market. One initiative establishes a "limit-up" and "limit-down" mechanism that prevents trades in individual exchange-listed stocks from occurring outside of a specified price band. The second initiative updates existing market-wide circuit breakers that,

when triggered, halt trading in all exchange-listed securities throughout the U.S. markets. The changes lower the percentage-decline threshold for triggering a market-wide trading halt and shorten the amount of time that trading is halted. The exchanges and FINRA will implement these changes by February 4, 2013; the SEC approved both proposals for a one-year pilot period, during which the exchanges, FINRA, and the SEC will assess their operation and consider whether any modifications are appropriate.

Further, in July 2011, the SEC adopted a new large-trader reporting rule that is designed to provide the SEC with a valuable source of useful data to support its investigative and enforcement activities, to facilitate the SEC's ability to assess the impact of large-trader activity on the securities markets, to reconstruct trading activity following periods of unusual market volatility, and to analyze significant market events for regulatory purposes. Additionally, in June 2011, the SEC adopted Rule 15c3-5, which, among other things, requires BDs to maintain a system of controls and supervisory procedures reasonably designed to limit the financial exposures arising from customers that access the markets directly through the BD.

Recent CFTC actions have addressed risk controls by requiring futures exchanges to establish risk controls that prevent and reduce the potential for price distortions and market disruptions, including pauses or halts on trading when necessary. The CFTC has also required clearing member firms to conduct automated, pre-trade screening of orders and required futures exchanges to have automated, pre-trade systems that facilitate firms' management of financial risk. The CFTC also adopted measures that require swap dealers and major swap participants to implement policies and procedures for testing and supervising trading programs and requires "straight-through processing" by futures commission merchants, swap dealers, and major swap participants of trades submitted for clearing. Each of these measures responds to the increased speed and automation of CFTC-regulated financial markets by requiring a parallel increase in the speed and automation of pre-trade risk controls, post-trade processing, and other steps designed to reduce risk and increase trade certainty.

6.2.5 Financial Market Utilities

Financial market utilities (FMUs) manage or operate multilateral systems for the purpose of transferring, clearing, or settling financial transactions.

Title VIII of the Dodd-Frank Act establishes a new supervisory framework for systemically important FMUs. It authorizes the Council to designate an FMU as systemically important if the failure of or a disruption to the functioning of the FMU could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system. The Council proposed the designation of a set of FMUs as systemically important at its May 22, 2012, meeting. As discussed further in Section 6.4.1, the Council designated eight FMUs as systemically important at its July 18, 2012, meeting.

The Federal Reserve, CFTC, and SEC, in consultation with each other and with the Council, have published proposed rules regarding risk-management standards for designated FMUs subject to their respective supervisory authority. The CFTC published its final rule with respect to all FMUs that are derivatives clearing organizations in November 2011. The Federal Reserve's, CFTC's, and SEC's final rules on risk management standards that will apply to designated FMUs are expected in 2012.

6.2.6 Securitization

Risk Retention

Section 941 of the Dodd-Frank Act added a new Section 15G to the Securities Exchange Act of 1934, requiring a securitizer to retain at least 5 percent of the credit risk for loans or other assets that a securitizer, through the issuance of an asset-backed security (ABS), transfers, sells, or conveys to a third party. On April 29, 2011, the OCC, Federal Reserve, FDIC, SEC, FHFA, and the Department of Housing and Urban Development (HUD) jointly published proposed rules to implement this risk-retention requirement. The rulewriting agencies are carefully assessing the provisions of the proposed rule in light of the public comments received and are working to develop a final rule. The Chairperson of the Council is coordinating the rulemaking.

As required by Section 15G, the proposed rules would, in general, require securitizers of ABS to retain at least 5 percent of the credit risk of the assets underlying the securitization. The credit risk retained generally could not be directly or indirectly transferred or hedged. The proposed rule includes a menu of risk-retention options designed to meet the statutory risk-retention requirement in a way that takes into account the wide variety of established securitization structures and market practices. Section 15G specifically provides that a securitizer is not required to retain the 5 percent credit risk if all of the loans that collateralize the ABS are qualified residential mortgages (QRMs), as defined by the rulewriting agencies. The definition of a QRM in the proposed rule takes into account underwriting standards and loan features that historically indicate a lower risk of default, as required by the statute. These include loan documentation and verification of the borrower's ability to repay the loan, the loan-to-value ratio of the loan, and the debt-to-income ratio of the borrower. In addition, if certain other loan underwriting standards are met, the proposed rule would exempt ABS collateralized exclusively by commercial loans, commercial mortgages, or automobile loans from the 5 percent risk-retention requirement. In crafting the proposed rule, the agencies sought to ensure that the amount of credit risk retained is meaningful, while reducing the potential for the proposed rules to negatively affect the availability and cost of credit to consumers and businesses.

SEC Rules Related to ABS

Other provisions of the Dodd-Frank Act require SEC rulemaking for ABS. Pursuant to Section 943 of the Dodd-Frank Act, the SEC adopted final rules in January 2011 that require securitizers to disclose, in tabular form, fulfilled and unfulfilled repurchase requests made in connection with outstanding

ABS. Repurchases often result from a loan that does not comply with the representations and warranties made in an underlying transaction pooling agreement. The rules also require that nationally recognized statistical rating organizations include information regarding the representations, warranties, and enforcement mechanism available to investors in an ABS offering in any report accompanying a credit rating issued in connection with such offering. Pursuant to Section 945, the SEC also adopted final rules in January 2011 requiring an issuer of ABS registered under the Securities Act of 1933 to perform a review of the assets underlying the ABS and to disclose information about the nature of the review. Under the rules, the issuer must also disclose information about (1) how the loans in the pool differ from the loan underwriting criteria disclosed in the prospectus, (2) loans that did not meet the disclosed underwriting criteria but were included in the pool, and (3) the entity that made the determination that loans be included in the pool even though they did not meet the disclosed underwriting standards.

Section 942(b) of the Dodd-Frank Act requires the SEC to adopt regulations to require issuers of ABS, at a minimum, to disclose asset-level or loan-level data regarding the assets backing the ABS, if such data are necessary for investors independently to perform due diligence. In April 2010, the SEC had proposed significant revisions to rules regarding the offering process, disclosure, and reporting for asset-backed securities, including revisions to Regulation AB. As part of its April 2010 proposal, to augment existing pool-level disclosure requirements, the SEC had proposed to require that standardized asset-level data points regarding each asset in the underlying pool be provided at the time of securitization and on an ongoing basis. In July 2011, the SEC issued a release requesting additional comment on whether the April 2010 proposals appropriately implement Section 942(b) of the Dodd-Frank Act.

In September 2011, the SEC proposed rules under Section 621 of the Dodd-Frank Act that would prohibit securitization participants of an ABS for a designated time period from engaging in certain transactions that would involve or result in a material conflict of interest.

6.2.7 Audit Standards

In the last year, the Public Company Accounting Oversight Board (PCAOB) has engaged in several projects related to auditing and professional practice standards. The PCAOB proposed a new auditing standard, Related Parties, and amendments to existing standards regarding significant unusual transactions, intended to enhance audit procedures in areas that have, at times, been used to engage in fraudulent financial reporting; proposed a new standard and amendments intended to enhance the relevance and quality of the communications between an auditor and a company's audit committee; proposed auditing and attestation standards that would apply to the audits of SEC-registered BDs and to the supplemental information accompanying audited financial statements; and proposed amendments to improve the transparency of public company audits by requiring the disclosure of the audit engagement partner's name in the audit report and the disclosure of other independent public accounting firms and other persons that took part in the audit.

In addition, on June 21, 2011, the PCAOB issued a concept release seeking public comment on the potential direction of a standard-setting project on the content and form of auditors' reports on financial statements.

Finally, on August 16, 2011, the PCAOB issued a concept release seeking public comment on ways that auditor independence, objectivity, and professional skepticism can be enhanced, including through mandatory rotation of audit firms. Mandatory audit firm rotation would limit the number of consecutive years for which a registered public accounting firm could serve as the auditor of a public company. The PCAOB received over 600 public comments on its release and is continuing to evaluate these ideas.

6.2.8 Accounting

The Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) are continuing their work to finalize converged standards in several major areas, including revenue recognition, lease accounting, financial instruments, and insurance contracts. In their revenue-recognition project, the FASB and IASB are working to clarify and align the principles for recognizing revenue. The FASB and IASB are considering comments from constituents on their joint 2011 proposal, and a final joint standard on revenue recognition is expected by early 2013. In their lease-accounting project, the FASB and IASB are working to provide greater transparency to lease arrangements by requiring balance sheet recognition of the rights and obligations associated with leases. The FASB and IASB are considering comments on their 2010 proposal, and a new joint proposal for public comment is expected in the second half of 2012. In the area of financial instruments, the FASB and IASB are seeking to more closely align key aspects of their classification and measurement models and to develop a new approach to impairment for financial instruments. The FASB and IASB are expected to release a new proposal on impairment for financial instruments in the second half of 2012. For insurance contracts, the IASB currently does not have a comprehensive insurance model in IFRS. The FASB is evaluating this issue, including joint discussions with the IASB regarding whether to propose changes to the existing U.S. insurance accounting model to provide users of financial statements with more useful information. Further documents or proposals from FASB and IASB are expected in the second half of 2012.

6.3 Consumer and Investor Protection

6.3.1 Consumer Protection

On January 4, 2012, President Obama appointed former Ohio Attorney General Richard Cordray as the Director of the CFPB. The CFPB is an independent bureau within the Federal Reserve System. It has rulemaking authority under specifically listed statutes, as well as specified supervisory and enforcement authority for very large depository institutions and non-depository (nonbank) entities and other duties relating to consumer financial products and services. The CFPB is the primary federal regulator exclusively focused on, and accountable to Congress and the public for, consumer financial protection. The CFPB has launched its supervision program for very large depository institutions (in coordination with prudential regulators) and for nonbanks; established its

consumer response function; assumed rulemaking responsibility for federal consumer financial laws transferred to the CFPB on July 21, 2011; and issued a variety of rules and reports required under the Dodd-Frank Act. In addition, the CFPB continues to work to ensure that consumers have the information they need to understand the costs and risks of consumer financial products and services, so they can compare products and choose the ones that are best for them. Moreover, the CFPB is taking steps to clarify and streamline regulations and guidance to reduce unnecessary burdens on providers of consumer financial products and services.

One of the CFPB's first rulemaking initiatives is consolidation of mortgage loan disclosure forms under the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA) to make the information more useful to consumers and to reduce burdens on lenders. The Dodd-Frank Act consolidates rulemaking authority for the two statutes in the CFPB. The CFPB proposed regulations and model disclosures in July 2012. As part of its "Know Before You Owe" initiative, the CFPB has been testing prototype disclosure forms that contain information required to be disclosed to consumers who apply for a loan to purchase a house or refinance an existing mortgage loan.

In addition, the CFPB has been testing a prototype for a monthly mortgage statement designed to make it easier for borrowers to understand costs and fees associated with mortgage loans. The Dodd-Frank Act amends the TILA and requires creditors, assignees, or servicers to send the borrower a periodic statement for each billing cycle; the statement must include information about the mortgage's principal loan amount, current interest rate, date on which the interest rate may next reset, and a description of any late payment fees, among other items. The CFPB plans, in the summer of 2012, to propose a rule, including a proposed form, to implement this requirement and several other servicing-related requirements under the Dodd-Frank Act.

The Dodd-Frank Act also amends the Electronic Fund Transfer Act to provide protections to consumers who transfer funds to recipients located in another country (remittance transfers), and the CFPB adopted a rule implementing these consumer protections. In general, the rule requires remittance transfer providers to disclose to a consumer the exchange rate, fees, and amount to be received by the recipient when the consumer sends a remittance transfer. The CFPB also requested public comment on whether the rule should include a safe harbor to exempt community banks, credit unions, and other companies that process less than a certain number of remittance transfers per year from the new requirements. The final rule, with any adjustments, will go into effect on February 7, 2013.

The CFPB has supervision authority over certain nonbank entities, including mortgage companies, private education lenders, payday lenders, and "larger participants" of a market for other consumer financial products or services. On February 17, 2012, the CFPB published its initial proposed rule to define larger participants in the consumer reporting and debt collection markets. The CFPB indicated that it will issue additional rules to define criteria for larger participants

in other consumer financial markets, selecting the appropriate criteria and thresholds for each of those markets.

The Federal Reserve, FDIC, OCC, and NCUA have worked closely with the CFPB to help ensure a smooth transition of the CFPB's examination and rulemaking authorities. These activities have included the transfer of certain staff to the CFPB and the development of information and examination coordination memoranda of understanding. For its part, the CFPB consults actively with the Federal Reserve, FDIC, OCC, and NCUA in the rulemaking process to help promote regulatory effectiveness and to meet the goals and requirements of the Dodd-Frank Act regarding consultation.

6.3.2 Mortgage Transactions and Housing

Title XIV of the Dodd-Frank Act, the "Mortgage Reform and Anti-Predatory Lending Act," contains several measures designed to protect consumers in mortgage transactions. Many of these measures were enacted as amendments to the TILA and the RESPA. Prior to July 21, 2011, the Federal Reserve was responsible for regulations implementing the TILA requirements and HUD was responsible for RESPA, but those rulemaking authorities transferred to the CFPB on that date. In addition to the CFPB's efforts to develop improved mortgage servicing disclosure standards (see previous text), the prudential regulators are working to develop regulations under safety and soundness authority that address the servicing of performing and nonperforming mortgage loans, which would supplement the CFPB's TILA and RESPA rulemaking. Certain additional rules concerning appraisals must be promulgated on an interagency basis. The CFPB expects to issue proposals to implement a number of Title XIV requirements in the summer of 2012 and to finalize several rules by January 2013, including the rules described in the following text.

Under new standards regarding residential mortgages, a lender is required to make a reasonable, good faith determination of an applicant's ability to repay before issuing a closed-end mortgage loan. In general, the "ability to repay" standard can be met if the loan is a "qualified mortgage," as defined under the Dodd-Frank Act and by regulation. A lender receives certain protections from liability if a loan is a "qualified mortgage." The CFPB is responsible for finalizing a proposed rule that was issued by the Federal Reserve in May 2011. The Dodd-Frank Act also requires escrow accounts to be established for certain mortgage loans and mandates certain new disclosures regarding escrow accounts. The Federal Reserve issued a proposed rule to implement these requirements in March 2011, and the CFPB is responsible for finalizing that rule. In addition, the Dodd-Frank Act expands the range of mortgage loans that are subject to the Home Ownership and Equity Protection Act and imposes new requirements on high-cost mortgages. These include mandatory counseling and other protections. For mortgage servicers, there will be requirements concerning provision of monthly statements, disclosures for hybrid adjustable rate mortgages, force-placed insurance, prompt crediting of payments, pay-off amounts, and error resolution. There also will be new requirements concerning compensation and qualification of mortgage loan originators, such as brokers and loan officers, and, for certain purposes, the companies that hire them. The Dodd-Frank Act also amends the

Equal Credit Opportunity Act to require mortgage lenders to provide certain disclosures and copies of appraisal documents to consumers.

Subtitle F of Title XIV of the Dodd-Frank Act relates to appraisal reform, and certain additional rules concerning appraisals must be promulgated on an interagency basis. For higher-risk mortgages, the Dodd-Frank Act generally requires written appraisals based on a physical inspection of the property and, in some cases, second appraisals. The FDIC, Federal Reserve, OCC, NCUA, FHFA, and CFPB have authority under the Dodd-Frank Act to issue joint regulations and guidance on appraiser independence and are required to issue regulations on the appraisal requirements for higher-risk mortgages, appraisal management companies, and automated valuation models.

6.3.3 Investor Protection

The Dodd-Frank Act includes various provisions to strengthen investor protection. These provisions include regulation of the over-the-counter derivatives markets and governance and compensation reform. Under Section 926 of the Dodd-Frank Act, the SEC is required to adopt rules that disqualify securities offerings involving certain felons and other “bad actors” from relying on the safe harbor from Securities Act registration provided by Rule 506 of Regulation D. The SEC proposed rules to implement the requirements of this provision in May 2011. In addition, the SEC adopted rule amendments in December 2011 implementing Section 413(a) of the Dodd-Frank Act, which requires the value of an individual’s primary residence to be excluded when determining if that individual’s net worth exceeds the \$1 million threshold required for “accredited investor” status.

The investing public should benefit from increased oversight of investment advisers. Approximately 2,500 investment advisers with assets under management between \$25 million and \$100 million are transitioning from oversight by the SEC to oversight by state securities regulators. This transition, mandated by Section 410 of the Dodd-Frank Act and implemented by June 2011 rulemakings by the SEC, is expected to result in more frequent examinations of the approximately 17,000 smaller, local advisers, while also allowing the SEC to focus its resources on the approximately 10,000 larger, national advisers.

The securities laws also were modified in a number of ways to facilitate SEC enforcement actions. These changes include enhancing the application of antifraud provisions and providing authority to bring actions against aiders and abettors. For example, the Dodd-Frank Act established a whistleblower program that requires the SEC to pay an award to eligible whistleblowers that voluntarily provide the SEC with original information about a violation of the federal securities laws that leads to the successful enforcement of certain judicial or administrative actions. In May 2011, the SEC adopted rules to implement this provision. Since the rules went into effect in August 2011, the SEC has received hundreds of tips through the program, and the quality of the information received has, in many instances, been particularly helpful to the SEC’s investigative staff.

6.3.4 Governance and Compensation

To facilitate prudent risk management at financial institutions and to align the interests of executives and other employees with the long-term health of their organizations, Section 956 of the Dodd-Frank Act requires the Federal Reserve, FDIC, FHFA, NCUA, OCC, and SEC to jointly prescribe rules or guidelines that require certain covered financial institutions to disclose to their appropriate federal regulator the structure of the incentive-based compensation arrangements offered by such covered financial institution sufficient to determine whether the compensation structure (1) provides an executive officer, employee, director, or principal shareholder of the covered financial institution with excessive compensation, fees, or benefits; or (2) could lead to material financial loss to the covered financial institution. Further, Section 956 requires the appropriate federal regulators jointly to prescribe regulations or guidelines that prohibit any types of incentive-based payment arrangement, or any feature of such arrangement, that the regulators determine encourages inappropriate risks by providing an executive officer, employee, director, or principal shareholder of the covered financial institution with excessive compensation, fees, or benefits, or that could lead to material financial loss to the covered firm. The proposed rule would impose additional requirements on the payment of incentive compensation to executive officers of certain larger covered financial institutions.

In April 2011, the agencies published a three-part proposed rule for public comment. First, a financial institution with \$1 billion or more in total consolidated assets (a covered financial institution) would be required to file an annual report with its appropriate federal regulator describing the structure of the firm's incentive-based compensation arrangements. Second, the proposed rule would prohibit a covered financial institution from establishing or maintaining an incentive-based compensation arrangement that could lead to material financial loss or that encourages inappropriate risks by providing certain "covered persons" (which include all executives, employees, directors, and principal shareholders) with excessive compensation. Finally, the proposed rule would require each covered financial institution to adopt specific policies and procedures approved by its board to help ensure and monitor compliance with the rule.

Section 952 of the Dodd-Frank Act requires the SEC to, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any equity security of an issuer that does not comply with new compensation committee and compensation adviser requirements. In June 2012, the SEC adopted rules to implement Section 952 that require, among other things, that the exchanges establish listing standards that require each member of a listed issuer's compensation committee to be a member of the board of directors and to be "independent." The SEC also is required by the Dodd-Frank Act to adopt several additional rules related to corporate governance and executive compensation, including rules mandating new listing standards relating to specified "clawback" policies, and new disclosure requirements about executive compensation and company performance, executive to median employee pay ratios, and employee and director hedging. These provisions of the Dodd-Frank Act do not contain rulemaking deadlines,

but SEC staff is working to develop recommendations for the SEC concerning the implementation of these provisions.

6.4 Council Activities

6.4.1 Determination of Nonbank Financial Companies to Be Supervised by the Federal Reserve and Designation of Financial Market Utilities

Nonbank Financial Companies

One of the Council's statutory purposes is to identify risks to financial stability that could arise from the material financial distress or failure, or ongoing activities, of nonbank financial companies. Under Section 113 of the Dodd-Frank Act, the Council is authorized to determine that a nonbank financial company's material financial distress—or the nature, scope, size, scale, concentration, interconnectedness, or mix of its activities—could pose a threat to U.S. financial stability. Such companies will be subject to consolidated supervision by the Federal Reserve and enhanced prudential standards.

The Dodd-Frank Act provides a list of 10 considerations the Council must use in making determinations under Section 113. In fall 2010, the Council began a rulemaking process to further clarify these statutorily mandated considerations. The Council issued an advance notice of proposed rulemaking (ANPR) in October 2010 and an NPR in January 2011. The Council received significant input from market participants, nonprofits, academics, and members of the public about the need to develop an analytic framework for making determinations that would provide a consistent approach and incorporate both quantitative and qualitative judgments. In response to comments the Council received on the NPR, the Council sought public comment on a second NPR and proposed interpretive guidance in October 2011 to provide (1) additional details regarding the framework that the Council intends to use to assess whether the material financial distress or failure, or ongoing activities, of a nonbank financial company could pose a threat to U.S. financial stability; and (2) further opportunity for public comment on the Council's proposed approach to the determination process. In April 2012, the Council adopted a final rule and interpretive guidance.

The Council's interpretive guidance includes an analytic framework that organizes the 10 statutory considerations into six broad categories that reflect a company's role in the financial system and its potential to experience material financial distress. In addition, the interpretive guidance describes the three-stage process that the Council intends to use in evaluating companies in non-emergency situations, defines key terms related to the Council's determination authority, and sets forth uniform quantitative thresholds that the Council intends to use to identify companies for further evaluation. While the Council's assessments of companies will be based on a fact-specific evaluation of the statutory considerations, the rule and interpretive guidance describe the characteristics of companies the Council likely will evaluate for potential determination and the factors the Council intends to use when analyzing companies.

In non-emergency situations, before a Council vote on any proposed determination, the company under consideration will have an opportunity to submit written materials to the Council regarding the proposed determination. Council members will vote on a proposed determination only after they have reviewed that information, and the proposed determination will proceed only if approved by two-thirds of the Council, including the affirmative vote of the Chairperson. Upon a proposed determination, a company may request a hearing, and the determination will be finalized only after a subsequent two-thirds vote of the Council, including the affirmative vote of the Chairperson. Any final determination will be subject to judicial review, and the Council must submit a report to Congress on, among other things, all determinations made under Section 113 of the Dodd-Frank Act and the basis for such determinations.

As of the date of this report, the Council has not made any determinations under Section 113 of the Dodd-Frank Act.

Financial Market Utilities

The Dodd-Frank Act authorizes the Council to designate an FMU as “systemically important” if the Council determines that the failure of or a disruption to the functioning of the FMU could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system.

Designated FMUs will become subject to the heightened prudential and supervisory provisions of Title VIII, which promote robust risk management and safety and soundness, including conducting their operations in compliance with applicable risk-management standards; providing advance notice and review of changes to their rules, procedures, and operations that could materially affect the nature or level of their risks; and being subject to relevant examination and enforcement provisions. Title VIII also requires the supervisory agencies to consult with each other when they are prescribing their respective risk-management standards, jointly develop risk-management supervisory programs, and consult and coordinate in planning and conducting examinations. To further strengthen settlement processes, the Federal Reserve Board may authorize a Federal Reserve Bank to provide accounts and settlement services to designated FMUs. Additionally, under unusual or exigent circumstances, designated FMUs could potentially gain access to the Federal Reserve’s discount window.

Following the publication of its final rule outlining the criteria, processes, and procedures for the designation of FMUs on July 27, 2011, the Council proposed the designation of an initial set of FMUs on May 22, 2012. At its July 18, 2012, meeting, the Council voted unanimously to designate eight FMUs as systemically important under Title VIII of the Dodd-Frank Act.

The FMUs that the Council designated perform a variety of functions in the market, including the clearance and settlement of cash, securities, and derivatives transactions; many of them are central counterparties and are responsible for clearing a large majority of trades in their respective markets. The Council believes that the completion of the FMU designations process for this initial set

of FMUs is a major milestone in the implementation of the Dodd-Frank Act and that the designation of these entities will instill confidence in their respective markets. The basis for the Council's designation determination for each of these systemically important FMUs is described in Appendix A.

6.4.2 Risk Monitoring

One of the Council's central purposes is the ongoing identification of risks to U.S. financial stability. To help identify risks, promote market discipline, and respond to emerging threats, the Council facilitates information sharing, coordination, and communication among member agencies, among other things.

In the past year, the Council examined significant market developments and structural issues within the financial system, including topics discussed elsewhere in this report. The Council will continue to monitor potential threats to financial stability, whether from external shocks or structural weaknesses.

To facilitate this risk monitoring process, the Council established the Systemic Risk Committee (SRC), composed primarily of member agency staff in supervisory, surveillance, examination, and policy roles. The SRC serves as a forum for member agency staff to identify and analyze potential risks that may extend beyond the jurisdiction of any one agency.

6.4.3 Reports Required Under the Dodd-Frank Act

Prompt Corrective Action

In December 2011, the Council released a report to Congress on prompt corrective action (PCA). Section 202(g)(4) of the Dodd-Frank Act required the Council to issue a report on actions taken in response to the Government Accountability Office (GAO) study on PCA required by Section 202(g)(1) of the Dodd-Frank Act. The Council's report discusses the existing PCA framework and the findings and recommendations of the GAO study. The Council's report also highlights some lessons learned from the financial crisis and outlines actions taken that could affect PCA, as well as additional steps to modify the PCA framework that could be considered.

Report on Actions Taken in Response to the GAO's Report on the NCUA

In June 2012, the Council released a report to Congress on actions taken in response to a GAO report on the NCUA's supervision of corporate credit unions and implementation of PCA, as required by the National Credit Union Authority Clarification Act. The report discusses the findings and recommendations of the GAO study and outlines NCUA activities that relate to the GAO's recommendations.

Contingent Capital

Section 115(c) of the Dodd-Frank Act requires the Council to study the feasibility, benefits, costs, and structure of a contingent capital requirement for nonbank financial companies supervised by the Federal Reserve and large, interconnected bank holding companies. In July 2012, the Council submitted a report to Congress regarding the study, as required by Section 115(c). The Council's report

concludes that contingent capital instruments should continue to be an area for private sector innovation, and encourages the Federal Reserve and other financial regulators to continue to study the advantages and disadvantages of including contingent capital and bail-in instruments in their regulatory capital frameworks.

6.4.4 Rulemaking Coordination

As Chairperson of the Council, the Treasury Secretary is required to coordinate two major rulemakings under the Dodd-Frank Act.

To facilitate the joint rulemaking on credit risk retention for asset-backed securities, as described previously, certain member agencies participated in an interagency working group to develop the NPR for public comment. The Federal Reserve, FDIC, SEC, OCC, HUD, and FHFA issued a joint NPR on March 30, 2011, that proposes rules to implement this requirement and represents a significant step toward strengthening securitization markets. The agencies extended the comment period for the proposed rule from June 10, 2011, to August 1, 2011.

The Chairperson of the Council is also required to coordinate the issuance of final regulations implementing the Volcker Rule, as described in Section 6.1.4. The Chairperson has played an active role in coordinating the agencies' work to develop regulations that are comparable and provide for consistent application, to the extent possible. The Federal Reserve, FDIC, OCC, and SEC sought public comment on a proposed rule in October 2011, and the CFTC requested comment on a substantively identical NPR in January 2012. The comment period closed February 13, 2012, for the proposed rules issued by the Federal Reserve, FDIC, OCC, and SEC, and closed on April 16, 2012, for the CFTC's proposed rule. The Chairperson of the Council continues to coordinate the development of a final rule.

6.4.5 Operations of the Council

The Dodd-Frank Act requires the Council to convene no less than quarterly. In the last year, the Council met 12 times.³ The meetings bring Council members together to discuss and analyze emerging market developments and financial regulatory issues. The Council is committed to conducting its business as openly and transparently as practicable, given the confidential supervisory and sensitive information at the center of its work. Consistent with the Council's transparency policy, the Council opens its meetings to the public whenever possible. The Council held a public session at three of its meetings in the last year.

Approximately every two weeks, the Council's Deputies Committee, which is composed of senior representatives of Council members, has convened to discuss the Council's agenda and to direct the work of the SRC and the five other functional committees. The other functional committees are organized around the Council's ongoing statutory responsibilities: (1) identifying nonbank financial companies and financial market utilities for designation; (2) making recommendations to primary financial regulatory agencies regarding heightened prudential standards for financial firms; (3) consulting with the FDIC on orderly liquidation authority and reviewing the resolution plan requirements for

designated nonbank financial firms and the largest BHCs; and (4) collecting data and improving data-reporting standards.

In the last year, the Council adopted regulations implementing its Freedom of Information Act obligations,⁴ adopted hearing procedures for nonbank financial companies and FMUs subject to proposed designations, and passed its second budget. The Council also complied with its transparency policy by conducting its business in an open and transparent manner whenever possible.⁵

Financial Research Fund Assessments

Section 155 of the Dodd-Frank Act requires the Treasury, with the approval of the Council, to establish assessments to fund the OFR's budget, which includes the expenses of the Council and the FDIC's implementation expenses associated with OLA. To implement this provision, on May 21, 2012, the Treasury issued a final rule that establishes an assessment schedule for semiannual collections from bank holding companies with total consolidated assets of \$50 billion or greater and an interim final rule that applies to nonbank financial companies supervised by the Federal Reserve. The first payments under the rule will be made on July 20, 2012.

6.4.6 Section 119 of the Dodd-Frank Act

Section 119 of the Dodd-Frank Act provides that the Council may issue nonbinding recommendations to member agencies on disputes about the agencies' respective jurisdiction over a particular BHC, nonbank financial company, or financial activity or product. (Certain consumer protection matters, for which another dispute mechanism is provided under Title X of the Act, are excluded). To date, no member agency has approached the Council to resolve a dispute under Section 119.